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# TRANSCRIPT OF RECORD

## Supreme Court of the United States

OCTOBER TERM, 1931

## No. 575

NORTH AMERICAN OIL CONSOLIDATED,
PETITIONER,

*vs.*

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED DECEMBER 14, 1931

CERTIORARI GRANTED JANUARY 25, 1932

(36,389)

# (36,389)

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DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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[1*] DOCKET No. 8714.

Appeal of NORTH AMERICAN OIL CONSOLIDATED

vs.

COMMISSIONER OF INT. REV.

APPEARANCES.

For Taxpayer: (CHAS. D. HAMEL, Esq.

Withdrawn— (LEE I. PARKS, Esq.
(R. S. DOYLE, Esq.
HERBERT W. CLARK, Esq., and
LEON F. de FREMERY

For Commissioner: A. GEORGE BOUCHARD, Esq., and
SHELBY FAULKNER, Esq.

DOCKET ENTRIES.

1925.

Nov. 2—Petition received and filed.

Nov. 6—Copy of petition served on solicitor.

Nov. 6—Notification of receipt mailed taxpayer.

Nov. 7—Motion for leave to file amended petition with amended petition, filed by taxpayer.

Nov. 11—Granted—Both sides notified.

Nov. 14—Copy of amended petition served on solicitor.

*Page-number appearing at the top of page of original certified Transcript of Record.

1926.

Jan. 5—Answer filed by solicitor.

Jan. 9—Copy of answer served on taxpayer—Assigned to general calendar.

July 9—Withdrawal of appearance of L. D. Latham, filed.

Sept. 16—Motion for field hearing filed by taxpayer.

Sept. 17—Granted. Both sides notified.

1927.

Jan. 29—Amended answer filed by G. C.

Feb. 3—Copy of answer served on taxpayer—Gen. Cal. Copy served 2-23-27.

Feb. 25—Hearing set for 5-2-27 at San Francisco.

Mar. 25—Motion to amend filed by taxpayer—amendment tendered.

Apr. 1—Motion to file amendments to amended petition filed by taxpayer. Amendment tendered.

Apr. 4—Granted. Both sides notified.

Apr. 6—Copy of motion and amended petition served on general counsel.

Apr. 9—Application for subpoena filed by taxpayer.

Apr. 11—Subpoena issued.

May 2—Hearing had before Mr. Arundell on merits—amendment to amended answer to amended petition filed at hearing. Briefs due 8-1-27.

June 2—Transcript vol. 1—5 inc. of hearing 5-2-27, filed.

June 16—Motion for extension to 9-1-27 to file brief—filed by taxpayer.

July 16—Granted. Both sides notified.
Aug. 31—Brief filed by G. C.
Sept. 1—Brief filed by taxpayer.
Sept. 1—Findings of fact filed by taxpayer.

1928.

May 24—Findings of fact and opinion rendered. Judgment will be entered rule 50.

1929.

Aug. 20—Motion for order of redetermination, filed by G. C.
Aug. 22—Hearing set Sept. 11, 1929, on notice under Rule 50.

[2] DOCKET No. 8714.

1929.

Aug. 23—Consent to settlement filed by taxpayer.
Aug. 29—Decision entered, C. Rogers Arundell, Div. 7.

1930.

Feb. 13—Petition for review to U. S. Circuit Ct. of Appeals, 9th Circuit, with assignments of error filed by G. C.
Feb. 14—Proof of service filed by G. C.
Feb. 21—Notice of withdrawal of C. D. Hamel, R. S. Doyle and Lee I. Park as counsel for taxpayer, filed.
Feb. 26—Petition for review by U. S. Cir. Ct. of Ap. (9) with assignments of error filed by taxpayer.
Feb. 26—Proof of service filed by taxpayer.
Feb. 27—Proof of service of petition for review filed. (Taxpayer.)

Mar. 12—Notice of appearance of Herbert W. Clark and Leon F. de Fremery as counsel for taxpayer, filed.

Mar. 31—Motion for extension to June 10, 1930, for preparation of evidence and transmission and delivery of record filed by G. C.

Apr. 1—Order enlarging time to June 10, 1930, to prepare statement of evidence and transmit record, entered.

Apr. 14—Motion for enlargement of time to June 10, to prepare statement of evidence and transmit record, filed by taxpayer.

Apr. 16—Order extending time to June 10, 1930, for preparation of evidence and delivery of record *sur* petition for review, entered.

May 29—Motion for extension to Sept. 10, 1930, to settle and transmit record filed by G. C.

June 2—Order enlarging time to 9-10-30 for preparation of evidence and delivery of record, *sur* petition for review, entered.

June 9—Motion for extension to Aug. 1, 1930, to settle and transmit record, filed by taxpayer.

June 10—Order enlarging time to Sept. 10, 1930, for preparation and transmission of evidence, entered.

Aug. 11—Motion for extension to Nov. 10, 1930, to

prepare and deliver record filed by G. C.

Aug. 13—Order entered enlarging time to Nov. 10, 1930, for preparation of evidence and transmission and delivery of Record *sur* petition for review, entered.

Aug. 30—Motion for extension to Nov. 10, 1930, to prepare and deliver record, filed by taxpayer.

Sept. 2—Order entered enlarging time to Nov. 10, 1930, for preparation of evidence and delivery of records *sur* petition for review entered.

Oct. 11—Praecipe filed by G. C.

Oct. 11—Statement of evidence lodged by G. C.

Oct. 11—Proof of service of praecipe filed.

Oct. 11—Notice of lodgment of statement and hearing on Oct. 23, 1930, filed.

Oct. 23—Statement of evidence approved and ordered filed.

Oct. 23—Hearing had before Mr. Arundell, Div. 7, on approval of statement of evidence.

Nov. 10—Order extending time for transmission of record to Dec. 1, 1930, entered.

Now, November 6, 1930, the foregoing docket entries certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[3] DOCKET No. 16,107.

Appeal of NORTH AMERICAN OIL CONSOLIDATED

vs.

COMMISSIONER OF INTERNAL REVENUE.

APPEARANCES.

For Taxpayer: C. D. HAMEL, Esq.
Withdrawn— L. I. PARKS, Esq.
R. S. DOYLE, Esq.
HERBERT W. CLARK, Esq., and
LEON F. de FREMERY, Esq.
For Commissioner: A. G. BOUCHARD, Esq.
SHELBY FAULKNER, Esq.

DOCKET ENTRIES.

1926.

May 18—Petition received and filed.
May 21—Copy of petition served on solicitor.
May 21—Notification of receipt mailed taxpayer.
June 24—Answer filed by solicitor.
Aug. 7—Copy of answer served on taxpayer. General calendar.
Sept. 16—Motion to transfer to filed calendar filed by taxpayer.
Sept. 17—Granted—both sides notified.

1927.

Jan. 25—Amended answer filed by G. C.

Feb. 3—Copy of answer served on taxpayer—assigned to general calendar.

Feb. 3—Copy of amended answer served on taxpayer.

Feb. 25—Hearing date set 5-2-27, San Francisco, Cal.

Apr. 9—Application for subpoena filed by taxpayer.

Apr. 11—Subpoena issued.

May 2-6—Hearing had before Mr. Arundell on merits. Amendment to amended answer to amended petition. Briefs due 8-1-27.

June 2—Transcript of hearing of May 2d, 3d, 4th, 5th and 6th, 1927, filed. (5)

June 15—Motion for extension of time to 9-1-27 to file brief, filed by taxpayer.

June 16—Granted. Both sides notified.

Aug. 31—Brief filed by G. C.

Sept. 1—Brief filed by taxpayer.

Sept. 1—Findings filed by taxpayer.

1928.

May 24—Findings of fact and opinion rendered, Mr. Arundell. Judgment will be entered under Rule 50.

1929.

Aug. 20—Motion for order of redetermination filed by G. C. See 8714.

Aug. 22—Hearing set Sept. 11, 1929, on notice under Rule 50.

Aug. 23—Consent to settlement filed by taxpayer. See 8714.

Aug. 29.—Order and decision entered. C. Rogers Arundell, Div 7.

1930.

Feb. 13—Petition for review to U. S. Circuit Ct. of Appeals, 9th Circuit, with assignments of error, filed by G. C. See 8714.

Feb. 14—Proof of service filed.

Feb. 21—Notice of withdrawal of C. D. Hamel, R. S. Doyle and Lee I. Park as counsel for taxpayer, filed.

Feb. 26—Petition for review by U. S. Cir. Ct. of Ap. (9) with assignments of error, filed by taxpayer.

[4] DOCKET No. 16107.

1930.

Feb. 26—Proof of service filed by taxpayer.

Feb. 27—Proof of service of petition for review filed. (Taxpayer.)

Mar. 12—Notice of appearance of Herbert W. Clark and Leon F. de Fremery as counsel filed.

Mar. 31—Motion for extension to June 10, 1930, to settle and transmit record, filed by G. C.

Apr. 1—Order extending time to June 10, 1930, for preparation of evidence and delivery of record, entered.

Apr. 14—Motion for enlargement of time to June 10, 1930, to prepare evidence and transmit record, filed by taxpayer. See 8714.

Apr. 16—Order extending time to June 10, 1930, for preparation of evidence and delivery of record, entered.

May 29—Motion for extension to Sept. 10, 1930, to settle and transmit record filed by G. C.

June 2—Order enlarging time to Sept. 10, 1930, for preparation of evidence and delivery of record, entered.

June 9—Motion for extension to Aug. 1, 1930, to settle and transmit record, filed by taxpayer.

June 10—Order enlarging time to Sept. 10, 1930, for preparation of evidence and delivery of record, entered.

Aug. 11—Motion for extension to Nov. 10, 1930, for preparation of evidence and delivery of record filed by G. C.

Aug. 13—Order enlarging time to Nov. 10, 1930, to prepare and transmit record entered.

Aug. 30—Motion for extension to Nov. 10, 1930, to prepare and transmit record filed by taxpayer.

Sept. 2—Order entered enlarging time to Nov. 10, 1930, for preparation of evidence and delivery of record, *sur* petition for review.

Oct. 11—Praecipe filed by G. C.

Oct. 11—Proof of service filed.

Oct. 11—Statement of evidence lodged.

Oct. 11—Notice of lodgment of statement and of hearing on Oct. 23, 1930, filed.

Oct. 23—Statement of evidence approved and ordered filed.

Oct. 23—Hearing had before Mr. Arundell, Div. 7, on approval of statement of evidence.

Nov. 10—Order extending time for transmission of record to Dec. 1/30 entered.

Now, November 6, 1930, the foregoing docket entries certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[5] Filed Nov. 2, 1925.

United States Board of Tax Appeals.

DOCKET No. 8714.

Appeal of NORTH AMERICAN OIL CONSOLIDATED, 544 Market Street, San Francisco, California.

PETITION.

The above-named taxpayer hereby appeals from the determination of the Commissioner of Internal Revenue, set forth in his deficiency letter (IT:CA: 2558–6–60–D), bearing on its face the date, September 28th, 1925, and as the basis of its appeal sets forth the following:

1. The taxpayer is a California corporation with its principal office at 915 Balfour Building, San Francisco, California.

2. The deficiency letter (a copy of which is at-

tached) purports on its face to have been mailed to the taxpayer on September 28th, 1925, and states a deficiency in tax of $109,239.61.

3. The taxes in controversy are income and profits taxes for the calendar year 1917, and are more than $10,000, to wit: $109,239.61.

4. The determination of tax contained in said deficiency letter is based upon the following [6] errors.

(a) The Commissioner of Internal Revenue erred in failing and refusing to permit the taxpayer to deduct in determining its income for the calendar year 1917, the sum of $8,000 paid by the taxpayer as an ordinary and necessary business expense to the Oil Industry Association.

(b) The Commissioner of Internal Revenue erred in treating the $8,000 paid to the Oil Industry Association as a donation and not deductible.

(c) The Commissioner of Internal Revenue erred in failing and refusing to permit the taxpayer to deduct in determining its taxable income for the year 1917, $5,271.50 paid by the taxpayer for the repair and replacement of oil derricks damaged by fire.

(d) The Commissioner of Internal Revenue erred in requiring the taxpayer to capitalize the $5,271.50 expended by it during the year 1917 in repairing and replacing oil derricks damaged by fire.

(e) The Commissioner of Internal Revenue erred in including in the taxpayer's taxable income for 1917, $20,441.18, representing four per cent of

the oil recovered during that year from Section 2, T. 32 S., R. 23 E, Kern County, California, in which oil the taxpayer had no interest, and which oil was the [7] property of Charles S. Wheeler and John F. Bowie.

(f) The Commissioner of Internal Revenue erred in including in the taxpayer's taxable income for 1917, $20,441.18, and in treating said amount as a capital expenditure made by the taxpayer for the purpose of defending its title to Section 2, T. 32 S., R. 23 E., Kern County, California.

(g) The Commissioner of Internal Revenue erred in adding to the taxpayer's taxable income for the year 1917, $5,765.94 expended by the taxpayer as an ordinary and necessary business expense in the purchase and installation of gas pumping engines, sucker rods, small receiving oil tanks, well casing and tubing.

(h) The Commissioner of Internal Revenue erred in capitalizing $5,765.94 expended by the taxpayer during the year 1917 for the acquisition and installation of gas pumping engines, sucker rods, small oil receiving tanks, well casing and tubing.

(i) The Commissioner of Internal Revenue erred in failing and refusing to permit a deduction by the taxpayer for depletion for 1917, of oil properties located on Section 16, T. 32 S., R. 23 E., in Kern County, California, in the amount of $93,892.18.

(j) The Commissioner of Internal Revenue erred in limiting the taxpayer's deduction for depletion for the year 1917 of oil properties in said Section 16, T. 32 S., R. 23 E., to $43,917.54.

[8] (k) The Commissioner of Internal Revenue erred in reducing the taxpayer's invested capital for the calendar year 1917 in the amount of $33,882.51 alleged to represent a profit realized in 1918 on a 1914 contingent sale, which sale had been fully consummated in 1914 and the profit therefrom determined during that year.

(l) The Commissioner of Internal Revenue erred in reducing the taxpayer's invested capital for the calendar year 1917 in the amount of $602,820.96 alleged to represent depletion sustained in prior years.

(m) The Commissioner of Internal Revenue erred in reducing the taxpayer's invested capital for the calendar year 1917 in the amount of $1,638,611.21 alleged to represent excess valuation of property.

5. The facts upon which the taxpayer relies in support of its appeal are as follows:

(a) During the calendar year 1917, the taxpayer paid the sum of $8,000 to the Oil Industry Association. The Oil Industry Association was an organization created and maintained for the purpose of supplying the oil industry with statistics and other general information bearing on that industry. This association was not operated for profit. It was dependent upon amounts paid it by various oil companies to whom it supplied information.

[9] (b) The Commissioner of Internal Revenue erroneously disallowed as a deduction the amount paid by the taxpayer to the Oil Industry

Association on the ground that it constituted a donation. The amount paid was in nowise a donation. It was paid for services rendered by the Oil Industry Association and constituted an ordinary and necessary business expense.

(c) During the year 1917 certain of the oil derricks located on taxpayer's producing lands were damaged or destroyed by fire. In the repair and replacement of those oil derricks, the taxpayer necessarily expended during 1917 $5,271.50. This amount was deducted by the taxpayer in determining its 1917 taxable income as an ordinary and necessary business expense incurred in the maintenance and operation of producing wells.

(d) The Commissioner of Internal Revenue erroneously disallowed the deduction of $5,271.50 in determining the taxpayer's 1917 income on the ground that this represented a capital expenditure. The Commissioner then erroneously deducted from the taxpayer's 1917 income $1,646.19 alleged to represent the depreciated cost of the oil derricks damaged or destroyed by fire during 1917. The amount of $1,646.19 did not represent actual depreciated cost but depreciated cost as estimated by the Commissioner.

[10] (e) On January 1, 1916, the taxpayer entered into a contract with Charles S. Wheeler and John F. Bowie, attorneys at law, of San Francisco, California, by the terms of which the attorneys agreed to defend for the taxpayer a suit in which the United States sought to cancel all right, title and interest of the taxpayer to Section 2, T.

32 S., R. 23 E., M. D. M., Kern County, California. By the terms of the contract, if the attorneys were successful in defending this suit, they became absolute owners of four per cent of all the oil in Section 2. This contract ran with the land and was binding upon the taxpayer and all subsequent owners thereof.

(f) The attorneys named were successful in defending the taxpayer's title to said Section 2. In accordance with the terms of said contract, the attorneys received during the year 1917, $20,441.18, representing four per cent of all the oil recovered during that year from said Section 2. This portion of the oil recovered during that year was the absolute property of the attorneys. The taxpayer had no right, title or interest in said oil.

(g) The Commissioner of Internal Revenue erroneously added $20,441.18 representing four per cent of the oil recovered from said Section 2 during 1917, to the taxpayer's income for that year. The Commissioner of Internal Revenue should have valued [11] the said contract on January 1, 1916, and have capitalized the value thereof as of that date and added said value to the cost to the taxpayer of said Section 2.

(h) During the year 1917, the taxpayer expended $5,765.94 in the purchase and installation of gas pumping engines, sucker rods, small receiving tanks, well casing and tubing. The Commissioner of Internal Revenue erroneously disallowed this deduction and required the taxpayer to capitalize said $5,765.04.

(i) The gas pumping engines in question were used for the purpose of operating the pumps which drew the oil from the wells. These engines were operated continuously twenty-four hours a day, were exposed to the action of the elements, and in no event had a useful life in excess of one year.

The sucker rods are jointed rods inserted in the well tubing to which is attached the pump which draws the oil from the ground. These rods operate continuously twenty-four hours a day and are subject to great wear and tear and do not have a useful life in excess of one year.

The small oil receiving tanks are small tanks of fifty to one hundred barrel capacity. They are of thin gauge sheet metal construction and have a useful life of not more than one year.

The well casing is composed of a number of joints inserted in the drill hole. The replacement [12]

*The well casing is composed of a number of joints inserted in the drill hole. The replacement* of well casing joints in producing wells is a maintenance charge and constitutes an ordinary and necessary business expense. Tubing is placed inside the casing. The pump and sucker rods operate inside the tubing. The tubing is subject to great wear and tear due to the action of the pump and sucker rods and does not have a useful life in excess of one year.

(j) In determining the taxpayer's depletion on its properties for the year 1917, the Commissioner allowed a deduction of $101,368.87. Of this amount $57,451.33 was allowed on Section 2, T. 32 S., R.

23 E., Kern County, California. The balance $43,917.54 represents depletion allowed on Section 16, T. 32 S., R. 23 E. The Commissioner should have allowed as depletion on said Section 16, $93,892.18 on the basis of the March 1, 1913, value thereof.

(k) During the year 1914, the taxpayer sold certain oil properties in Section 4, T. 11 N., R. 23 W., S. B. M., Kern County, California. Payment was to be made thereafter in oil as produced. The taxpayer determined in 1914 its profit from this transaction, which was duly reported to its stockholders and taken into its books of account.

(l) On January 1, 1917, there was still due to the taxpayer on said contract, $33,882.51. [13] In determining the taxpayer's invested capital for 1917, the Commissioner deducted the amount stated above. This amount, $33,882.51 should have been included in the taxpayer's invested capital for all years subsequent to 1914, including the year 1917, as the profit was actually realized during the year 1914.

(m) In determining the taxpayer's invested capital for 1917, the Commissioner reduced the invested capital as shown by its books by the amount of $602,820.96 alleged to represent depletion sustained in prior years. Inasmuch as depletion has been held not to be a charge against capital, this reduction was erroneous.

(n) Prior to February 10, 1910, the date of the organization of this taxpayer as a corporation, the Louis Titus Pool, a syndicate, and the Hartford

Oil Company, a corporation, began the acquisition of certain oil properties located in Sections 16, 22 and 26 in T. 32 S., R. 23 E., M. D. M., Kern County, California. No oil was being produced on these properties at the time of their acquisition by the syndicate and the Hartford Oil Company. During the latter part of 1909 and up to February 10, 1910, the syndicate and the corporation developed these properties and brought in several producing wells.

(o) On February 10, 1910, the Louis Titus Pool and the Hartford Oil Company sold all their [14] properties in the sections above named to this taxpayer in exchange for this taxpayer's bonds of the par value of $825,000.00 and this taxpayer's stock of the par value of $8,250,000.00. Subsequently, May 27th, 1912, based upon numerous sales to outside investors of taxpayer's stock, the par value of the stock was reduced, and twenty shares of the par value of $1.00 each were issued in exchange for each former share of the par value of $100.00. The properties acquired by the taxpayer on February 10, 1910, were thereupon carried on the taxpayer's books at their cost on the basis of bonds of the par value of $825,000.00 and stock of the par value of $1,650,000 issued therefor. The properties acquired by the taxpayer February 10, 1910, were worth at the date of acquisition and on March 1, 1913, and January 1, 1914, not less than the par of the securities issued therefor.

(p) The Commissioner of Internal Revenue in computing the taxpayer's invested capital for the calendar year 1917 erroneously reduced the tax-

payer's invested capital for that year in the amount of $1,638,611.21 alleged to represent "excess valuation of property." The properties in question were worth in February 10, 1910, March 1, 1913, and January 1, 1914, not less than the value at which they were carried on said taxpayer's books. The taxpayer's assets were [15] worth during the calendar year 1917 not less than the amount at which they were carried on the taxpayer's books.

6. The taxpayer in support of this appeal relies upon the following propositions of law:

(a) Section 12 of the Revenue Act of 1916, as amended, provides for the deduction in determining net income of all ordinary and necessary expenses incurred and paid during the taxable year.

(b) Sections 5 and 12 of the Revenue Act of 1916, as amended, and Article 170 of Regulations 33 issued under said Revenue Act of 1916, as amended, provide for a reasonable deduction for depletion of oil properties based on the March 1, 1913, value.

(c) Section 207 of the Revenue Act of 1917 provides for the inclusion in invested capital of the value as of January 1, 1914, of property paid in for stock.

(d) The Court of Claims in the case of Ludey vs. The United States held that depletion of oil properties was not a charge or depletion of capital.

WHEREFORE, this taxpayer respectfully prays that this Board may hear and determine its appeal.

CHARLES D. HAMEL,
RICHARD S. DOYLE,
L. DANA LATHAM,
Attorneys for Taxpayer.

[16] District of Columbia,
City of Washington,—ss.

Frank Evans, being first duly sworn deposes and says that he is the secretary of North American Oil Consolidated, the taxpayer named in the foregoing petition, and is duly authorized to verify the same; that he has read the said petition and that the facts stated therein are true.

FRANK EVANS.

Subscribed and sworn to before me this 2d day of November, A. D. 1925.

[Seal] MAMIE CAROLYN GILES,
Notary Public, D. C.

[17] TREASURY DEPARTMENT,
Washington.

September 28, 1925.

Office of
Commissioner of Internal Revenue.
IT:CO:2558-6-60-D
North American Oil Consolidated,
544 Market Street,
San Francisco, California.

Sirs:

The determination of your income and profits tax liability for the year 1917, as set forth in letter dated December 23, 1922, has been reconsidered

in connection with return filed, an examination of the books of account and records and a conference held in the Unit May 7, 1924, and a deficiency in tax, in the amount of $109,239.61 has been disclosed in accordance with the enclosed statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1924, you are allowed 60 days from the date of this letter within which to file an appeal to the Board of Tax Appeals contesting in whole or in part the correctness of this determination.

Where a taxpayer has been given an opportunity to appeal to the Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the enclosed agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C. for the attention of IT:CA:2558-6-60-D. In the event that you acquiesce in a part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully,

D. N. BLAIR,

Commissioner.

By (Signed) J. C. BRIGHT,

Deputy Commissioner.

Enclosures:
Statements,
Agreement—Form A.

[18] STATEMENT.

IT:CA-2558-6-60D.

In re: NORTH AMERICAN OIL CONSOLIDATED,
544 Market Street,
San Francisco, California.

| Year | Deficiency in Tax |
|---|---|
| 1917. | $109,239.61 |

1917.

| | | |
|---|---|---|
| Net Income reported on return | | $150,700.74 |
| Add: | | |
| 1. Donations disallowed | $8,035.00 | |
| 2. Burned wells rebuilt | 5,271.50 | |
| 3. Income Tax | 285.07 | |
| 4. Legal expense defending title | 35,795.54 | |
| 5. Capital expenditures disallowed as expense. | 5,765.94 | |
| 6. Receivers expense for 1916. | 722.00 | |
| 7. Contingent profit on 1914 sale | 32,293.47 | |
| 8. Salaries of officers for 1916 | 3,383.31 | |
| 9. Depletion disallowed | 155,160.91 | |

| | | | |
|---|---|---|---|
| 10. | Taxes in excess of accrual | 1,703.21 | $248,415.95 |
| | Total | | $399,116.69 |
| | Deduct: | | |
| 11. | Contingent profit on 1914 sale | $33,882.51 | |
| 12. | Fire loss sustained | 1,646.79 | |
| 13. | Donated stock credited to surplus | 200.00 | |
| 14. | Depreciation adjustment | 66,758.30 | |
| 15. | Legal expense not deducted | 14,560.85 | |
| 16. | Depreciation allowed | 13,917.44 | $130,965.29 |
| | Corrected Net Income | | $268,151.40 |

[19] In Re: North American Oil Consolidated.

Explanation of Adjustments to Net Income.

Statement.

1. Donations are not an allowable deduction under Article 135 of Regulations 33.

2. Burned wells rebuilt should be capitalized as agreed upon in conference of May 7, 1924.

3. Income tax has been disallowed as a deduction from income under Article 191 of Regulations 33.

4. Legal expense for defending title is a part of the cost of the property and should be capitalized, under Article 107, of Regulations 33.

5. Capital expenditures for casing, tubing, etc., have been disallowed as expense, as per conference of May 7, 1924.

6. Receiver's expense for 1916 has been disallowed as a deduction for 1917.

7. Contingent profit on 1914 sale realized in 1917 has been added to income. (See Contra Item 11.)

8. Salaries of officers for 1916 have been disallowed as a deduction for 1917.

9. Depletion disallowed has been computed as follows:

Depletion claimed $256,329.78, less depletion allowed, $101,368.87, equals $156,160.91, depletion disallowed.

10. Taxes paid in excess of accruals have been disallowed.

11. Contingent profit on 1914 sale shown by taxpayer has been allowed as a deduction, for the reason that the correct amount is shown under Item 7.

12. Fire loss sustained in 1917, not shown on the books, has been allowed as a deduction.

13. Donated stock credited to surplus has been allowed as a deduction account no profit realized.

14. Depreciation adjustment has been allowed as a deduction from income.

15. Legal expense not deducted has been allowed as a deduction from income.

16. Depreciation allowed as shown in the enclosed schedule has been allowed as a deduction.

[20] In Re: North American Oil Consolidated.

Statement.

Invested Capital.

Capital stock and surplus shown by the balance Sheet as at December 31, 1916 ..... $1,998,558.66

| | | | |
|---|---|---|---|
| | Add: | | |
| 1. | Paid in surplus account stock sales in 1910 ..... | $50,000.00 | |
| 2. | Organization expenses | 20,000.00 | |
| 3. | Depreciation charged off restored ..... | 730,788.95 | |
| 4. | Depletion charged off restored ..... | 203,036.51 | 1,003,825.46 |
| | Total ..... | | $3,002,384.12 |
| | Deduct: | | |
| 5. | Salaries of officers for 1916 ..... | 3,393.31 | |
| 6. | Receivers expense for 1916 ..... | 722.00 | |
| 7. | Donations for 1916.. | 7,000.00 | |
| 8. | Income tax paid in 1916 ..... | 156.67 | |
| 9. | Contingent profit on 1914 sale ..... | 33,882.51 | |
| 10. | Depreciation allowed, prior years ..... | 293,495.51 | |
| 11. | Depletion sustained, prior years ..... | 602,820.96 | |
| 12. | Excess valuation of property ..... | 1,638,611.21 | 2,580,072.17 |
| | Adjusted invested capital ..... | | $ 422,311.95 |

Explanation of Adjustments to Invested Capital.

1. Paid in surplus (or appreciation of section

16) has been allowed as recommended by Valuation Section Report dated July 30, 1925.

2. Organization expenses charged off in 1910 has been restored to invested capital.

3. Depreciation charged off in books has been restored account corrected deduction as shown under Item 10.

[21] In Re: North American Oil Consolidated.
Statement.

4. Depletion charged off in books has been restored account the corrected deductions as shown under Item 11.

5. Salaries of officers for 1916 have been deducted from invested capital as of December 31, 1916.

6. Receiver's expense for 1916 has been deducted from invested capital as at December 31, 1916.

7. Donations for 1916 have been deducted from invested capital as at December 31, 1916.

8. Income tax paid in 1916 has been deducted from invested capital as at December 31, 1916.

9. Contingent profit on 1914 sale has been disallowed as an addition to invested capital prior to the actual receipt thereof.

10. Depreciation allowed for prior years has been computed as shown by the enclosed schedule and is considered fair and reasonable.

11. Depletion sustained for prior years has been allowed as shown in Oil and Gas Valuation report dated July 30, 1925, a copy of which has been furnished you.

12. Excess valuation of property paid in for stocks and bonds has been disallowed as a part of invested capital.

Computation of Tax.

| | |
|---|---|
| Excess profits tax | $109,613.40 |
| 2% Income tax | 3,170.96 |
| 4% Income tax | 6,341.52 |
| Total Tax assessable | $119,125.68 |
| Original tax assessed | 9,886.07 |
| Deficiency in Tax | $109,239.61 |

The information contained in the return, Revenue Agent's report and your protest, has been carefully considered in determining the tax liability as set forth herein.

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

Statement.

Depreciation on Schedule.

| Property. | 1910. | 1911. | 1912. | 1913. | 1914. |
|---|---|---|---|---|---|
| 20% assets ..... | $37,983.99 | $59,668.13 | $49,723.45 | $44,648.61 | $44,881.96 |
| 40% assets ..... | 31,010.95 | 26,477.39 | 15,113,42 | 26,088.60 | 18,734.71 |
| F. W. and Section 14 ..... | | | | 13,552.26 | 2,599.40 |
| Totals ..... | $68,994.94 | $86,145.52 | $64,836.87 | $84,269.95 | $66,206.07 |
| F. W. and Section 14, ..... | | | | 4,589.55 | 8,898.60 |
| Section 22, ..... | 43,031.83 | 91,961.53 | 70,456.36 | 49,901.92 | 41,656,50 |
| Section 26, ..... | 19,603.09 | 47,377.16 | 51,187.94 | 48,815.66 | 34,,086.33 |
| Grand Total..... | $131,629.86 | $225,494.21 | $186,481.17 | $185,577.08 | $150,848.50 |
| Accumulated Total ..... | $131,629.86 | $357,114.07 | $643,595.24 | $729,172.32 | $880,020.02 |

David Burnet vs.

| Property | 1915 | 1916. | 1917. | 1918. | 1919. |
|---|---|---|---|---|---|
| 20% assets | $53,917.22 | $15,801.94 | $12,496.47 | $9,665.42 | $7,714.59 |
| 40% assets | 9,396.35 | 5,061.99 | 1,420.97 | 3,026.10 | 2,054.90 |
| F. W. and Section 14 | | | | | |
| Totals | 33,313.57 | $20,863.93 | $13,917.44 | $12,691.52 | $9,769.49 |
| F. W. a... Section 14, Section 22, Section 23 | $23,830.09 | | | | |
| Grand Total | 57,143.66 | $20,863.93 | $13,917.44 | $12,691.44 | $9,769.49 |
| Accumulated, Total | $937,164.48 | $958,028.41 | $307,412.95 | $320,104.47 | $329,873.96 |
| Accumulated, total on property sold and abandoned | | 664,532.90 | | | |
| Accumulated depreciation revised | | $293,495.51 | $307,412.95 | $320,104.47 | $329,873.96 |

[23] In re: North American Oil Consolidated.

Statement.

Condensed Balance Sheet as at January 1, 1917.

| | | |
|---|---|---|
| Assets, other than Oil Wells and Equipment ..... | | $501,544.09 |
| Depreciation on above..... | | 289,078.34 |
| Organization expense..... | | |
| Oil Lands, Wells and Equipment ..... | | 1,204,582.25 |
| Total ..... | | $2,015,202.68 |
| Liabilities, balance sheet.. | $1,254,250.73 | |
| Accrued officers' salaries.. | 3,383.31 | |
| Accrued donations ..... | 7,000.00 | |
| Accrued receivers expense. | 722.00 | |
| Accrued income tax..... | 156.67 | |
| Contingent profit ..... | 33,882.51 | |
| Depreciation allowed.... | 293,495.51 | 1,592,890.73 |
| Invested capital ..... | | $422,311.95 |

[24] Filed Nov. 11, 1925.

United States Board of Tax Appeals.

DOCKET No. 8714.

Appeal of NORTH AMERICAN OIL CONSOLIDATED, 544 Market Street, San Francisco, California.

AMENDED PETITION.

The above-named taxpayer hereby appeals from

the determination of the Commissioner of Internal Revenue, set forth in his deficiency letter (IT:CA:-2558–6–60–D), bearing on its face the date, September 28th, 1925, and as the basis of its appeal sets forth the following:

1. The taxpayer is a California corporation with its principal office at 915 Balfour Building, San Francisco, California.

2. The deficiency letter purports on its face to have been mailed to the taxpayer on September 28th, 1925, and states a deficiency in tax of $109,-239.61.

3. The taxes in controversy are income and profits taxes for the calendar year 1917, and are more than $10,000, to wit: $109,239.61.

4. The determination of tax contained in the said deficiency letter is based upon the following [25] errors.

(a) The Commissioner of Internal Revenue erred in proposing any additional tax against the taxpayer for the calendar year 1917, because the determination, assessment and collection of any additional tax for the year 1917 was barred by the statute of limitations provided by Section 250 (d) of the Revenue Act of 1921, and Section 277 of the Revenue Act of 1924.

(b) The Commissioner of Internal Revenue erred in failing and refusing to permit the taxpayer to deduct in determining its income for the calendar year 1917, the sum of $8,000 paid by the taxpayer as an ordinary and necessary business expense to the Oil Industry Association.

(c) The Commissioner of Internal Revenue erred in treating the $8,000 paid to the Oil Industry Association as a donation and not deductible.

(d) The Commissioner of Internal Revenue erred in failing and refusing to permit the taxpayer to deduct in determining its taxable income for the year 1917, $5,271.50 paid by the taxpayer for the repair and replacement of oil derricks damaged by fire.

(e) The Commissioner of Internal Revenue erred in requiring the taxpayer to capitalize the [26] $5,271.50 expended by it during the year 1917 in repairing and replacing oil derricks damaged by fire.

(f) The Commissioner of Internal Revenue erred in including in the taxpayer's taxable income for 1917, $20,441.18, representing four per cent of the oil recovered during that year from Section 2, T. 32 S., R. 23 E., Kern County, California, in which oil the taxpayer had no interest, and which oil was the property of Charles S. Wheeler and John F. Bowie.

(g) The Commissioner of Internal Revenue erred in including in the taxpayer's taxable income for 1917, $20,441.18, and in treating said amount as a capital expenditure made by the taxpayer for the purpose of defending its title to Section 2, T. 32 S., R. 23 E., Kern County, California.

(h) The Commissioner of Internal Revenue erred in adding to the taxpayer's taxable income for the year 1917, $5,765.94 expended by the taxpayer as an ordinary and necessary business expense

in the purchase and installation of gas pumping engines, sucker rods, small receiving oil tanks, well casing and tubing.

(i) The Commissioner of Internal Revenue erred in capitalizing $5,765.94 expended by the taxpayer during the year 1917 for the acquisition and [27] installation of gas pumping engines, sucker rods, small oil receiving tanks, well casing and tubing.

(j) The Commissioner of Internal Revenue erred in failing and refusing to permit a deduction by the taxpayer for depletion for 1917, of oil properties located on Section 16, T. 32 S., R. 23 E., in Kern County, California, in the amount of $93,892.18.

(k) The Commissioner of Internal Revenue erred in limiting the taxpayer's deduction for depletion for the year 1917 of oil properties in said Section 16, T. 32 S., R. 23 E., to $43,917.54.

(l) The Commissioner of Internal Revenue erred in reducing the taxpayer's invested capital for the calendar year 1917 in the amount of $33,882.51 alleged to represent a profit realized in 1918 on a 1914 contingent sale, which sale had been fully consummated in 1914 and the profit therefrom determined during that year.

(m) The Commissioner of Internal Revenue erred in reducing the taxpayer's invested capital for the calendar year 1917 in the amount of $602,820.96 alleged to represent depletion sustained in prior years.

(n) The Commissioner of Internal Revenue erred in reducing the taxpayer's invested capital for the calendar year 1917 in the amount of $1,638,611.21 alleged to represent excess valuation of property.

5. The facts upon which the taxpayer relies in support of its appeal are as follows:

[28] (a) During 1923 the taxpayer filed an income and profits tax waiver for the year 1917, dated January 9, 1923. This waiver expired in accordance with Mim. 3085, Cumulative Bulletin II–1, page 74, on April 1, 1924. Subsequently on December 10th, 1924, the taxpayer filed a waiver covering the year 1917 which provided in part as follows:

> "This waiver is in effect from the date it is signed by the taxpayer, and will remain in effect for a period of one year after the expiration of the statutory period of limitation within which assessments of taxes may be made for the year or years mentioned, or the statutory period of limitation as extended by Section 277 (b) of the Revenue Act of 1924, or by any waivers already on file with the Bureau."

Under the terms of the last-mentioned waiver, the period of limitation expired April 1, 1925. The deficiency letter herein involved, bears on its face the date, September 28th, 1925.

(b) During the calendar year 1917, the taxpayer paid the sum of $8,000 to the Oil Industry Association. The Oil Industry Association was an organization created and maintained for the purpose of supplying the oil industry with statistics and

other general information bearing on that industry. This association was not operated for profit. It was dependent upon amounts paid it by various oil companies to whom it supplied information.

[29] (c) The Commissioner of Internal Revenue erroneously disallowed as a deduction the amount paid by the taxpayer to the Oil Industry Association on the ground that it constituted a donation. The amount paid was in nowise a donation. It was paid for services rendered by the Oil Industry Association and constituted an ordinary and necessary business expense.

(d) During the year 1917 certain of the oil derricks located on taxpayer's producing lands were damaged or destroyed by fire. In the repair and replacement of these oil derricks, the taxpayer necessarily expended during 1917, $5,271.50. This amount was deducted by the taxpayer in determining its 1917 taxable income as an ordinary and necessary business expense incurred in the maintenance and operation of producing wells.

(e) The Commissioner of Internal Revenue erroneously disallowed the deduction of $5,271.50 in determining the taxpayer's 1917 income on the ground that this represented a capital expenditure. The Commissioner then erroneously deducted from the taxpayer's 1917 income $1,646.19 alleged to represent the depreciated cost of the oil derricks [30] damaged or destroyed by fire during 1917. The amount of $1,646.19 did not represent actual depreciated cost but depreciated cost as estimated by the Commissioner.

(f) On January 1, 1916, the taxpayer entered into a contract with Charles S. Wheeler and John F. Bowie, attorneys at law, of San Francisco, California, by the terms of which the attorneys agreed to defend for the taxpayer a suit in which the United States sought to cancel all right, title and interest of the taxpayer to Section 2, T. 32 S., R. 23 E., M. D. M., Kern County, California. By the terms of the contract, if the attorneys were successful in defending this suit, they became absolute owners of four per cent of all the oil in Section 2. This contract ran with the land and was binding upon the taxpayer and all subsequent owners thereof.

(g) The attorneys named were successful in defending the taxpayer's title to said Section 2. In accordance with the terms of said contract, the attorneys received during the year 1917, $20,441.18, representing four per cent of all the oil recovered during that year from said Section 2. This portion of the oil recovered during that year was the absolute property of the attorneys. The taxpayer had no right, title or interest in said oil.

[31] (h) The Commissioner of Internal Revenue erroneously added $20,441.18 representing four per cent of the oil recovered from said Section 2 during 1917, to the taxpayer's income for that year. The Commissioner of Internal Revenue should have valued the said contract on January 1, 1916, and have capitalized the value thereof as of that date and added said value to the cost to the taxpayer of said Section 2.

(i) During the year 1917, the taxpayer expended $5,765.94 in the purchase and installation of gas pumping engines, sucker rods, small receiving tanks, well casing and tubing. The Commissioner of Internal Revenue erroneously disallowed this deduction and required the taxpayer to capitalize said $5,765.04.

(j) The gas pumping engines in question were used for the purpose of operating the pumps which drew the oil from the wells. These engines were operated continuously twenty-four hours a day, were exposed to the action of the elements, and in no event had a useful life in excess of one year.

The sucker rods are jointed rods inserted in the well tubing to which is attached the pump which draws the oil from the ground. These rods operate continuously twenty-four hours a day and are subject [32] to great wear and tear and do not have a useful life in excess of one year.

The small oil receiving tanks are small tanks of fifty to one hundred barrel capacity. They are of thin gauge sheet metal construction and have a useful life of not more than one year.

The well casing is composed of a number of joints inserted in the drill hole. The replacement of well casing joints in producing wells is a maintenance charge and constitutes an ordinary and necessary business expense. Tubing is placed inside the casing. The pump and sucker rods operate inside the tubing. The tubing is subject to great wear and tear due to the action of the pump and sucker rods and does not have a useful life in excess of one year.

(k) In determining the taxpayer's depletion on its property for the year 1917, the Commissioner allowed a deduction of $101,368.87. Of this amount $57,451.33 was allowed on Section 2, T. 32 S., R. 23 E., Kern County, California. The balance $43,917.54 represents depletion allowed on Section 16, T. 32 S., R. 23 E. The Commissioner should have allowed as depletion on said Section 16, $93,892.18 on the basis of the March 1, 1913, value thereof.

(l) During the year 1914, the taxpayer sold certain oil properties in Section 4, T. 11 N., R. 23 W., S. B. M., Kern County, California. Payment [33] was to be made thereafter in oil as produced. The taxpayer determined in 1914 its profit from this transaction, which was duly reported to its stockholders and taken into its books of account.

(m) On January 1, 1917, there was still due to the taxpayer on said contract, $33,882.51. In determining the taxpayer's invested capital for 1917, the Commissioner deducted the amount stated above. This amount, $33,882.51 should have been included in the taxpayer's invested capital for all years subsequent to 1914, including the year 1917, as the profit was actually realized during the year 1914.

(n) In determining the taxpayer's invested capital for 1917, the Commissioner reduced the invested capital as shown by its books by the amount of $602,820.96 alleged to represent depletion sustained in prior years. Inasmuch as depletion has been held not to be a charge against capital, this reduction was erroneous.

(o) Prior to February 10, 1910, the date of

the organization of this taxpayer as a corporation, the Louis Titus Pool, a syndicate, and the Hartford Oil Company, a corporation, began the acquisition of certain oil properties located in Sections 16, 22 and 26 in T. 32 S., R. 23 E., M. D. M., Kern County, California. No oil was being produced on these [34] properties at the time of their acquisition by the syndicate and the Hartford Oil Company. During the latter part of 1909 and up to February 10, 1910, the syndicate and the corporation developed these properties and brought in several producing wells.

(p) On February 10, 1910, the Louis Titus Pool and the Hartford Oil Company sold all their properties in the sections above named to this taxpayer in exchange for this taxpayer's bonds of the par value of $825,000.00 and this taxpayer's stock of the par value of $8,250,000.00. Subsequently, May 27th, 1912, based upon numerous sales to outside investors of taxpayer's stock, the par value of the stock was reduced, and twenty shares of the par value of $1.00 each were issued in exchange for each former share of the par value of $100.00 The properties acquired by the taxpayer on February 10, 1910, were thereupon carried on the taxpayer's books at their cost on the basis of bonds of the par value of $825,000.00 and stock of the par value of $1,650,000 issued therefor. The properties acquired by the taxpayer February 10, 1910, were worth at the date of acquisition and on March 1, 1913, and January 1, 1914, not less than the par of the securities issued therefor.

(q) The Commissioner of Internal Revenue in computing the taxpayer's invested capital for the [35] calendar year 1917 erroneously reduced the taxpayer's invested capital for that year in the amount of $1,638,611.21 alleged to represent "excess valuation of property." The properties in question were worth in February 10, 1910, March 1, 1913, and January 1, 1914, not less than the value at which they were carried on said taxpayer's books. The taxpayer's assets were worth during the calendar year 1917 not less than the amount at which they were carried on the taxpayer's books.

6. The taxpayer in support of this appeal relies upon the following propositions of law:

(a) Section 277 (a) of the Revenue Act of 1924 provides for the assessment and collection of all taxes under the Revenue Act of 1917 as amended, within five years after the return was filed.

(b) Section 12 of the Revenue Act of 1916, as amended, provides for the deduction in determining net income of all ordinary and necessary expenses incurred and paid during the taxable year.

(c) Sections 5 and 12 of the Revenue Act of 1915, as amended, and Article 170 of Regulations 33 issued under said Revenue Act of 1916, as amended, provide for a reasonable deduction for depletion of oil properties based on the March 1, 1913, value.

[36] (d) Section 207 of the Revenue Act of 1917 provides for the inclusion in invested capital of the value as of January 1, 1914, of property paid in for stock.

(e) The Court of Claims in the case of Ludey vs. The United States held that depletion of oil properties was not a charge or depletion of capital.

WHEREFORE, this taxpayer respectfully prays that this Board may hear and determine its appeal.

CHARLES D. HAMEL,
RICHARD S. DOYLE,
L. DANA LATHAM,
Attorneys for Taxpayer.

[37] District of Columbia,
City of Washington,—ss.

Frank Evans, being first duly sworn, deposes and says that he is the Secretary of the North American Oil Consolidated, the taxpayer named in the foregoing amended petition, and is duly authorized to verify the same; that he has read the said petition and that the facts stated therein are true.

(Signed) FRANK EVANS.

Subscribed and sworn to before me this 5th day of November, A. D. 1925.

[Seal] (Sgd.) MAMIE CAROLYN GILES,
Notary Public, D. C.

Now, November 6, 1930, the foregoing amended petition certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[38] Filed Jan. 5, 1926. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 8714.

Appeal of NORTH AMERICAN OIL CONSOLIDATED, San Francisco, California.

ANSWER.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, solicitor of Internal Revenue, for answer to the petition of the above-named taxpayer, admits, avers and denies as follows:

(1) Admits the allegations contained in paragraphs numbered 1, 2 and 3 of the taxpayer's petition and avers that the deficiency letter was mailed to the taxpayer on September 28, 1925.

(2) Admits that the taxpayer has filed three waivers for the year 1917 and denies that the tax liability of this taxpayer for the year 1917 is barred by any statute of limitations.

(3) Admits that the taxpayer paid the sum of $8,000.00 to the Oil Industry Association in 1917 but denies that the said payment was other than a donation or that it may be allowed as a deduction from gross income.

(4) Admits that certain of the taxpayer's oil derricks were damaged by fire in 1917 but denies that the loss sustained thereon exceeded the sum of $1,646.19 as allowed by the Commissioner.

(5) Admits that the cost of rebuilding and re-

placing certain oil derricks damaged by fire was the sum of $5,271.50 but denies that this amount constituted an allowable deduction from gross income or other than a capital expenditure.

[39] (6) Admits that the taxpayer paid approximately $20,441.18 during the year 1917 to its attorneys for defending or perfecting title to certain oil property but denies that this constituted a deductible expense or was other than a capital expenditure.

(7) Admits that the taxpayer purchased certain gas-engines, steel oil tanks and oil well casing and tubing during the year 1917 for the sum of $5,765.94, but denies that this equipment has a physical or useful life of less than one year or that this amount may be allowed as a deduction from gross income for the year 1917.

(8) Denies that the taxpayer is entitled to a deduction for depletion of its oil properties in the sum of $151,343.51, or any amount in excess of $101,368.87, based upon the fair market value of such property at March 1, 1913, and upon cost for that property subsequently acquired.

(9) Denies that the taxpayer did not realize a profit of $33,882.51 in 1917 on the sale of certain oil property or that this amount constituted invested capital for the year 1917.

(10) Admits that the Commissioner reduced the taxpayer's invested capital, by sustained depletion on oil properties in the sum of $602,820.96, but denies that depletion was not sustained or that in-

vested capital has been improperly reduced by this amount.

(11) Admits that the Commissioner reduced the taxpayer's invested capital by $1,638,611.21, but denies that the properties acquired for stock and bonds had an actual cash value in excess of the amount allowed by the Commissioner.

[40] (12). Denies, generally and specifically, each and every allegation of the petition not hereinbefore admitted, qualified or denied.

## PROPOSITIONS OF LAW.

(1) All proper deductions from gross income have been allowed this taxpayer as provided by Section 12 of the Revenue Act of 1917.

(2) The invested capital of this taxpayer has been correctly computed in accordance with the provisions of Section 207 of the Revenue Act of 1917.

WHEREFORE, it is prayed that the appeal be denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of Counsel:
BENJ. H. SAUNDERS,
Special Attorney,
Bureau of Internal Revenue.

Now, November 6, 1930, the foregoing answer certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[41] Filed Jan. 29, 1927. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 8714.

NORTH AMERICAN OIL CONSOLIDATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

## AMENDED ANSWER TO AMENDED PETITION.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for amended answer to the amended petition of the above-named taxpayer, admits, alleges and denies as follows:

(1) Admits the allegations contained in paragraphs numbered 1, 2 and 3 of the taxpayer's amended petition; and alleges that the deficiency letter was mailed to the taxpayer on September 28, 1925.

(2) Denies that the tax liability of the petitioner for the year 1917 is barred by the statute of limitations, as alleged in paragraphs 4 (a) and 5 (a) of the amended petition, and alleges the taxpayer filed a waiver November 17, 1925, waiving the time prescribed by law for making an assessment for the year 1917 until December 31, 1926.

(3) Admits the taxpayer paid the sum of $8,000.00 to the Oil Industry Association in 1917, but denies that said payment was other than a donation or that it may be allowed as a deduction from gross income.

(4) Admits that certain of the taxpayer's oil derricks were damaged by fire in 1917, but denies that the loss sustained thereon exceeded the sum of $1,646.19, as allowed by the Commissioner.

(5) Admits that the cost of rebuilding and replacing certain oil derricks damaged by fire was the sum of $5,271.50, but denies that this amount constituted an allowable deduction from gross income or other than a capital expenditure.

[42] (6) (a) Admits the taxpayer was engaged during the years 1916 and 1917 in a suit with the United States in which the United States sought to cancel all right, title, and interest of the taxpayer to Section 2, Township 32 South, Range 23 East, M.D.M. Kern County, California.

(b) Admits the taxpayer was successful in said suit against the United States.

(c) Admits that $20,441.18 represents approximately four per cent of all the oil recovered during the year 1917 from said section.

(d) Admits the taxpayer paid approximately $20,441.18 during the year 1917 to its attorneys for defending or perfecting title to certain oil property but denies that this constituted a deductible expense or was other than a capital expenditure.

(7) Alleges that during the litigation between the petitioner and the United States in the years

1916 and 1917, the oil revenue from said Section 2, Township 32 South, Range 23 East, M. D. M., was impounded, and that at the termination of the litigation in 1917 in favor of the taxpayer, the oil revenue accrued during the period of litigation was released to the taxpayer.

(8) Alleges further that the oil revenues for the year 1916 from said parcel which was impounded in the year 1916 and released to the taxpayer in 1917 was the sum of $253,150.96.

(9) Alleges that the Commissioner erred by failing to include in the taxpayer's income for the year 1917 the said sum of $253,150.96 received by the taxpayer in 1917.

(10) Admits that the taxpayer purchased certain gas-engines, steel oil tanks and oil-well casing and tubing during the year 1917 for the sum of $5,765.94, but denies that this equipment has a physical or useful life of less than one [43] year or that this amount may be allowed as a deduction from gross income for the year 1917.

(11) Denies that the taxpayer is entitled to a deduction for depletion of its oil properties in the sum of $151,343.51, or any amount in excess of $101,368.87 based upon the fair market value of such property at March 1, 1913 and upon cost for that property subsequently acquired.

(12) Denies that the taxpayer did not realize a profit of $33,882.51 in 1917 on the sale of certain oil property or that this amount constituted invested capital for the year 1917.

(13) Admits the Commissioner reduced the taxpayer's invested capital by sustained depletion on

oil properties in the sum of $602,820.96, but denies that depletion was not sustained or that invested capital has been improperly reduced by this amount.

(14) Admits that the Commissioner reduced the taxpayer's invested capital by $1,638,611.21 but denies that the properties acquired for stock and bonds had an actual cash value as of the date of acquisition, March 1, 1913, or January 1, 1914, in excess of the amount allowed by the Commissioner.

(15) Denies all allegations of the petition not hereinbefore expressly admitted or denied.

WHEREFORE, it is prayed that the appeal be denied and that the deficiency for the year 1917 as set forth in deficiency letter dated September 29, 1925, be increased by adding to corrected net income for said year, as shown in said letter, the sum of $253,150.96 and the tax liability computed thereon.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

A. GEORGE BOUCHARD,
Special Attorney,
Bureau of Internal Revenue.

Now, November 6, 1930, the foregoing amended answer to amended petition certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[44] Filed April 4, 1927.

United States Board of Tax Appeals.

DOCKET No. 8714.

NORTH AMERICAN OIL CONSOLIDATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

AMENDMENTS TO AMENDED PETITION.

The above-named petitioner by its counsel hereby amends its amended petition heretofore filed in the above cause by adding thereto but without waiving or abandoning any part thereof, the following assignment of errors and statement of facts:

4 (u) The Commissioner of Internal Revenue erred in adding to the petitioner's taxable income for the calendar year 1917 the sum of $32,293.47 alleged to represent a profit realized in 1917 on a 1914 contingent sale which sale had in fact been consummated in 1914 and the profit therefrom determined during that year.

5. The facts upon which the petitioner relies as the basis for the foregoing assignment of errors are as follows:

[45] (r) On December 17, 1914, petitioner entered into a contract for the sale of interest in Section 4, Township 11 North, Range 23 West, S. B. B. & M., Kern County, California, to the Miocene Oil Company. Petitioner was to be paid for said inter-

est in said section, the sum of $60,000 by retaining title to one-third of the net oil produced on said premises until the petitioner should receive the net sum of $60,000, said Miocene Oil Company being required to store said one-third of said net oil produced for 30 days or market the same and collect the proceeds thereof, without charge for said services to the petitioner. The petitioner considered the transaction as closed in 1914 and it was reflected on petitioner's books in said year as a closed transaction. In 1917 oil was discovered on said section and a part of the balance due on said contract was paid to the petitioner during said year. The total amount paid never exceeded the fair market value of said interest of petitioner in said section, either at the time the said interest was acquired by the petitioner in 1914 or at the time of the discovery in 1917. The respondent erroneously included the sum of $32,293.40 in the petitioner's net income for 1917 as a part of the alleged profit on said transaction.

CHARLES D. HAMEL,
RICHARD S. DOYLE,
LEE I. PARKS,
Attorneys for Petitioner,
906 Southern Building, Washington, D. C.

[46] City of Washington,
District of Columbia,—ss.

Charles D. Hamel, being duly sworn, deposes and says that he is one of the attorneys for the petitioner herein and that the facts stated in the foregoing amendments to the amended petition are true to the best of his knowledge and belief.

CHARLES D. HAMEL.

Subscribed and sworn to before me this 1st day of April, 1927.

MAMIE CAROLYN GILES,
Notary Public.

Now, November 6, 1930, the foregoing amendments to amended petition certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[47] Filed at Hearing May 2, 1927.

United States Board of Tax Appeals.

DOCKET No. 8714.

NORTH AMERICAN OIL CONSOLIDATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

AMENDMENT TO AMENDED ANSWER TO AMENDED PETITION.

The Commissioner of Internal Revenue by his attorney A. W. Gregg, General Counsel, Bureau of Internal Revenue, for amendment to amended answer to amended petition of the above-named taxpayer, alleges as follows:

That the respondent erred in determining petitioner's invested capital and depletion allowance for the year 1917 by adding to the capital sum re-

maining in the year 1916 the sum of $287,687.03 representing the capitalized cost of well development on Section 16, Township 32 South, Range 23 East during the year 1916, whereas in truth and in fact said sum was expende in drilling wells during the years 1910 and 1911 as follows: $51,727.64 in the year 1910 and $235,959.39 in the year 1911; that said sum of $287,687.03 should have been added to the capital sum during the years 1910 and 1911 instead of during the year 1916; that petitioner's invested capital for the year 1917 as shown in deficiency letter dated September 28, 1925, should be decreased in the sum of $131,930.22 and that the depletion allowance for the year 1917 as shown in said deficiency letter should be reduced by the sum of $11,224.00.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

A. GEORGE BOUCHARD,
Special Attorney,
Bureau of Internal Revenue.

Now, November 6, 1930, the foregoing amendment to amended answer to amended petition certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[48] Filed May 18, 1926.

United States Board of Tax Appeals.

DOCKET No. 16,107.

NORTH AMERICAN OIL CONSOLIDATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

## PETITION.

The above-named petitioner hereby petitions for a re-determination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, IT:CA:PYA-5-4-60D, dated April 9, 1926, and as a basis of its proceeding alleges as follows:

I.

The petitioner is a California corporation with its principal office and place of business at 915 Balfour Building, San Francisco, California.

II.

The notice of deficiency (copy of which is attached and marked Exhibit "A") purports to have been mailed to the petitioner on April 9, 1926.

III.

The taxes in controversy are income and profits taxes for the calendar years 1918 and 1919, and for $121,325.69.

[49] IV.

The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue erred in failing and refusing to permit the petitioner to deduct, in computing its taxable income for the year 1918, the sum of $7,096.41 paid by the petitioner for the repair of oil derricks damaged by fire.

(b) The Commissioner of Internal Revenue erred in requiring the petitioner to capitalize the sum of $7,096.41 expended by it during the year 1918 in repairing oil derricks damaged by fire.

(c) The Commissioner of Internal Revenue erred in adding to the petitioner's taxable income for the year 1918, the sum of $17,598.00, expended by the petitioner as an ordinary and necessary business expense in the purchase and installation of gasoline engines used in operating the pumps in the petitioner's various oil-wells.

(d) The Commissioner of Internal Revenue erred in capitalizing the sum of $17,598.00 expended by the petitioner during the year 1918 for the acquisition and installation of gasoline engines used in operating the pumps in the petitioner's various oil-wells.

(e) The Commissioner of Internal Revenue erred in adding to the petitioner's taxable income for the year 1919, [50] the sum of $5,049.28 expended by the petitioner as an ordinary and necessary business expense in the purchase and installation of gasoline engines used in operating the pumps in the petitioner's various oil-wells.

(f) The Commissioner of Internal Revenue erred in capitalizing the sum of $5,049.28 expended by the petitioner during the year 1919 for the acquisition and installation of gasoline engines used in operating the pumps in the petitioner's various oil-wells.

(g) The Commissioner of Internal Revenue erred in adding to the petitioner's taxable income for the year 1918, the sum of $1,589.04 alleged to represent a profit realized in 1918 on a 1914 contingent sale, which sale had, in fact, been consummated in 1914 and the profit therefrom determined during that year.

(h) The Commissioner of Internal Revenue erred in failing and refusing to permit a deduction by the petitioner for depletion sustained during the year 1918 on oil properties located in Section 16, T. 32 S., R. 23 E., M. D. M., in Kern County, California, in the amount of $69,206.19.

(i) The Commissioner of Internal Revenue erred in limiting the petitioner's deduction for depletion for the year 1918 of petitioner's oil properties on said Section 16, T. 32 S., R. 23 E., M. D. M. in Kern County, California, to $32,583.31.

[51] (j) The Commissioner of Internal Revenue erred in failing and refusing to permit a deduction by the petitioner in 1919 for depletion sustained during said year on oil properties located in Section 16, T. 32 S., R. 23 E., M. D. M. in Kern County, California, in the amount of $66,952.30.

(k) The Commissioner of Internal Revenue erred in limiting the petitioner's deduction for de-

pletion for the year 1919 of petitioner's oil properties on said Section 16, T. 32 S., R. 23 E., M. D. M. to $31,763.12.

(l) The Commissioner of Internal Revenue erred in reducing the petitioner's invested capital for the calendar year 1918 in the amount of $707,819.73, alleged to represent depletion sustained in prior years.

(m) The Commissioner of Internal Revenue erred in reducing the petitioner's invested capital for the calendar year 1919 in the amount of $819,751.89, alleged to represent depletion sustained in prior years.

(n) The Commissioner of Internal Revenue erred in reducing the petitioner's invested capital for the calendar year 1918 in the amount of $65,274.34, alleged to represent additional taxes for the year 1917 as prorated over the calendar year 1918.

(o) The Commissioner of Internal Revenue erred in reducing the petitioner's invested capital for the calendar [52] year 1919 in the amount of $33,217.57, alleged to represent additional taxes for the calendar year 1918 as prorated over the year 1919.

(p) The Commissioner of Internal Revenue erred in reducing the petitioner's invested capital for the calendar year 1919 in the amount of $109,239,61, alleged to represent additional taxes for the calendar year 1917.

(q) The Commissioner of Internal Revenue erred in reducing the petitioner's invested capital in the amount of $1,589.04 alleged to represent a profit realized in 1918 on a 1914 contingent sale, which sale

had been fully consummated in 1914 and the profit therefrom determined during that year.

(r) The Commissioner of Internal Revenue erred in reducing the petitioner's invested capital for the calendar year 1918 in the amount of $1,646.19, alleged to represent a fire loss in 1917.

(s) The Commissioner of Internal Revenue erred in reducing the petitioner's invested capital for the calendar year 1919 in the amount of $5,146.19, alleged to represent fire losses for the years 1917 and 1918.

(t) The Commissioner of Internal Revenue erred in reducing the petitioner's invested capital for each of the years 1918 and 1919 in the amount of $1,638,611.21 alleged to represent excess valuation of property.

[53] The facts upon which the petitioner relies as the basis of its proceeding are as follows:

(a) During the year 1918, certain of the oil derricks located on the petitioner's producing lands were damaged or destroyed by fire. In the repair and replacement of these oil derricks, the petitioner necessarily expended during the year 1918, the sum of $7,096.41. This amount was deducted by the petitioner in determining its 1918 taxable income as an ordinary and necessary business expense incurred in the maintenance and operation of producing wells.

(b) The Commissioner of Internal Revenue erroneously disallowed the deduction of $7,096.41 in determining the petitioner's 1918 income on the ground that it represented a capital expenditure. The Commissioner then erroneously deducted from

the petitioner's 1918 income the sum of $3,500.00, alleged to represent the depreciated cost of the oil derricks damaged or destroyed by fire during 1918. The amount of $3,500.00 did not represent actual depreciated cost, but depreciated cost as estimated by the Commissioner.

(c) During the years 1918 and 1919, the petitioner expended certain amounts in the purchase and installation of gasoline engines. The amount expended for 1918 was $17,598.00, and for 1919, $5,049.28. The Commissioner erroneously disallowed a deduction in each of the respective years for said amounts, alleging that they represented capital [54] expenditures rather than ordinary and necessary business expense. Said engines were used for the purpose of operating the pumps which drew oil from the petitioner's wells. These engines were operated continuously twenty-four hours a day; were constantly exposed to the action of the elements and in no event had a useful life in excess of one year.

(d) During the year 1914, the petitioner sold certain oil properties in Section 4, T. 11 N., R. 22 W., S. B. M., in Kern County, California. Payment therefor was to be made in oil as produced. The petitioner determined in 1914 its profits from this transaction, which were duly reported to its stockholders and taken into its books of account.

(e) On January 1, 1918, there was still due to the petitioner on said contract, the sum of $1,589.04. The Commissioner erroneously included said amount in the petitioner's taxable income for the

calendar year 1918, and erroneously excluded it from the petitioner's invested capital for said year. This amount should have been included in the petitioner's invested capital for all years subsequent to 1914, including the year 1918, as the profit was actually realized during the year 1914.

(f) In determining the petitioner's depletion on its properties for the calendar year 1918, the Commissioner allowed a deduction of $183,392.56. Of this amount, [55] $150,809.25 was allowed on Section 2, T. 32 S., R. 23 E., M. D. M. in Kern County, California. The balance, $32,583.31, represented depletion allowed on Section 16, T. 32 S., R. 23 E., M. D. M. The Commissioner should have allowed as depletion for 1918 on said Section 16, T. 32 S., R. 23 E., M. D. M., $69,206.19 on the basis of the March 1, 1913 value thereof.

(g) In determining the petitioner's depletion of its properties for the calendar year 1919, the Commissioner allowed a deduction of $260,929.22. Of this amount, $229,166.10 was allowed on Section 2, T. 32 S., R. 23 E., M. D. M., in Kern County, California. The balance, $31,763.12 represents depletion allowed on Section 16, T. 23 S., R. 23 E., M. D. M. The Commissioner should have allowed as depletion for 1919 on said Section 16, T. 32 S., R. 23 E. $66,952.30 on the basis of the March 1, 1913 value thereof.

(h) In determining the petitioner's invested capital for each of said years, the Commissioner of Internal Revenue has reduced invested capital as shown by the petitioner's books by the amount of $707,819.73 in 1918, and $819,751.89 in 1919, al-

leged to represent depletion sustained in prior years. Inasmuch as depletion has been held not to be a charge against capital, these reductions were erroneous.

[56] (i) The Commissioner has reduced invested capital for the year 1918 by the amount of $65,274.35, alleged to represent additional income and profits taxes for 1917 prorated. No portion of the alleged additional taxes for 1917 were ever due and the reduction of the 1918 invested capital by said amount was erroneous.

(j) The Commissioner of Internal Revenue has reduced the invested capital for 1919 by the amount of $43,422.44 alleged to represent additional taxes for 1918 prorated. No portion of the alleged additional taxes for 1918 were ever due and the reduction of the 1919 invested capital by said amount was erroneous.

(k) The Commissioner of Internal Revenue has reduced the invested capital for 1919 by the amount of $109,239.81, alleged to represent additional taxes for the year 1917. Reduction of invested capital in 1919 on account of said alleged additional taxes was erroneous.

(l) Prior to February 10, 1910, the date of the organization of this petitioner as a corporation, the Louis Titus Pool, a syndicate, and the Hartford Oil Company, a corporation, begun the acquisition of certain oil properties located in Sections 16, 22 and 26 in T. 32 S., R. 23 E., M. D. M. in Kern County, California. No oil was being produced on these properties at the time of their ac-

quisition by the syndicate and the Hartford Oil Company. During the latter part of 1909, and up to February 10, 1910, [57] the syndicate and the corporation developed these properties and brought in several producing wells.

(m) On February 10, 1910, the Louis Titus Pool and the Hartford Oil Company sold all their properties in the above-described sections to this petitioner in exchange for this petitioner's bonds of the par value of $825,000.00, and this petitioner's stock of the par value of $8,250,000.00. Subsequently, on May 27, 1912, based upon numerous sales to outside investors in petitioner's stock, the par value of the stock was reduced, and twenty shares of the par value of $1.00 each were issued in exchange for each former share of the par value of $100.00. The properties acquired by the petitioner on February 10, 1910, were thereupon carried on the petitioner's books at their cost on the basis of bonds of the par value of $825,000.00 and stock of the par value of $1,650,000.00 issued therefor. The properties acquired by the petitioner February 10, 1910, were worth at the date of acquisition and on March 1, 1913, not less than the par value of the securities issued therefor.

(n) The Commissioner of Internal Revenue, in computing the petitioner's invested capital for each of the calendar years 1918 and 1919 erroneously reduced the petitioner's invested capital for each of said years in the amount of $1,638,611.21 alleged to represent "excess valuation of property." The properties in question were worth on February 10,

1910, and March 1, 1913, not less [58] than the value at which they were carried on said petitioner's books. The petitioner's assets were worth during each of the calendar years in question not less than the amount at which they were carried on the petitioner's books.

VI.

The petitioner prays for relief from the deficiency asserted by the respondent on the following and each of the following particulars:

(a) That the Board may find that the petitioner should be allowed as a deduction from gross income for the calendar year 1918, the sum of $7,096.41 paid during said year by the petitioner for the repair of oil derricks damaged by fire.

(b) That the Board may find that the petitioner should be allowed as a deduction from gross income for the calendar year 1918, the sum of $17,598.00 expended during the said year by the petitioner as an ordinary and necessary business expense in the purchase and installation of gasoline engines for use in operating pumps in the petitioner's various oil-wells.

(c) That the Board may find that the petitioner should be allowed as a deduction from gross income for the calendar year 1919, the sum of $5,049.28 expended during said year by the petitioner as an ordinary and necessary business expense [59] in the purchase and installation of gasoline engines for use in operating pumps in the petitioner's various oil-wells.

(d) That the Board may find that the final pay-

ment received in 1918 on the 1914 sale of properties in Section 4, T. 11 N., R. 23 W. S. B. M., in the amount of $1,589.04 should not be included in the petitioner's gross income for said year.

(e) That the Board may find that the petitioner should be allowed as a deduction from gross income for the calendar year 1918, the sum of $69,206.19 for depletion of the petitioner's oil properties located on Section 16, T. 32 S., R. 23 E. M. D. M. in Kern County, California, based on the March, 1913 value thereof.

(f) That the Board may find that the petitioner should be allowed as a deduction from gross income for the calendar year 1919, the sum of $66,952.30 for depletion of the petitioner's oil properties located on Section 16, T. 32 S., R. 23 E. M. D. in Kern County, California, based on the March 1, 1913 value thereof.

(g) That the Board may find that the petitioner's invested capital for said years should not be reduced by the depletion sustained in prior years.

(h) That the Board may find that the amount of the final payment received in 1918 on the 1914 sale should [60] not be excluded from the petitioner's invested capital for said year.

(i) That the Board may find that the petitioner's invested capital for the years 1918 and 1919 should not be reduced on account of alleged fire losses in prior years.

(j) That the Board may find that the petitioner's invested capital for each of said years

should include the actual cash value of the property paid in at the time of incorporation as set up on petitioner's books of account.

WHEREFORE, the petitioner respectfully prays that the Board may hear and determine its appeal, and the petitioner further prays that the Board may give and grant the petitioner such other and further relief as in the premises the Board may deem fit and proper, and if the Board shall find that the petitioner has overpaid its taxes for the years under review, the Board may order and direct a refund of said taxes overpaid with interest thereon.

CHARLES D. HAMEL,
RICHARD S. DOYLE,
LEE I. PARK,
Attorneys for Petitioner,
906 Southern Building, Washington, D. C.

[61] State of California,
City and County of San Francisco.

Frank Evans, being first duly sworn, on oath deposes and says, that he is the secretary of the North American Oil Consolidated, the petitioner named in the foregoing petition, and is duly authorized to verify said petition; that he has read said petition and that the facts stated therein are true.

FRANK EVANS.

Subscribed and sworn to before me this 11th day of May, 1926.

[Seal] L. P. LOVELAND,
Notary Public in and for City and County of San Francisco, State of California.

[62] TREASURY DEPARTMENT,
Washington, D. C.

IT:CA:PYA-5-4-60D. April 9, 1926.

North American Oil Consolidated,
544 Market Street,
San Francisco, California.

Sirs:—

The determination of your income and profits tax liability for the years 1918 and 1919, as shown in office letter dated September 29, 1925, has been reconsidered in connection with an examination of the books of account and conference held in the Unit February 20, 1926, and a deficiency in tax in the amount of $121,325.69 has been disclosed in accordance with the enclosed statement.

In accordance with the provisions of Section 274 of the Revenue Act of 1926, you are allowed 60 days from the date of mailing of this letter within which to file a petition for the redetermination of this deficiency. Any such petition must be addressed to the United States Board of Tax Appeals, Earle Building, Washington, D. C., and must be mailed in time to reach the Board within the 60-day period, not counting Sunday as the sixtieth day.

Where a taxpayer has been given an opportunity to file a petition with the United States Board of

Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has filed a petition and an assessment in accordance with the final decision on such petition has been made, the unpaid amount of the assessment must be paid upon notice and demand from the Collector of Internal Revenue. No claim for abatement can be entertained.

If you acquiesce in this determination and do not desire to file a petition with the United States Board of Tax Appeals, you are requested to execute a waiver of your right to file a petition with the United States Board of Tax Appeals on the enclosed Form A, and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:CA:PYA-5-4-60D. In the event that you acquiesce in a part of the determination, the waiver should be executed with respect to the items to which you agree.

Respectfully,

D. H. BLAIR,
Commissioner.

Enclosures:
Statement,
Waiver—Form A.

[63] (Mailed April 9, 1926.)

STATEMENT.

IT:CA:PYA-5-4-60D.

In re: NORTH AMERICAN OIL CONSOLIDATED,
544 Market Street,
San Francisco, California.

| | Deficiency in Tax. |
|---|---|
| 1918 | $ 62,228.66 |
| 1919 | 59,097.03 |
| Total | $121,325.69 |

1918.

Net Income.

| | | |
|---|---|---|
| Net income reported in return | | $138,451.73 |
| Add: | | |
| 1. Interest receivable accrued | $ 3,750.00 | |
| 2. Donations disallowed | 38.00 | |
| 3. Income tax accrued | 5,952.36 | |
| 4. Excessive depreciation disallowed | 29,532.09 | |
| 5. Wells rebuilt | 7,096.41 | |
| 6. Capital expenditures (engines) | 17,598.00 | |
| 7. Contingent profit realized | 1,589.04 | |
| 8. Drilling tools and machinery sold | 6,516.10 | 72,072.00 |
| Total | | $210,523.73 |

| | | |
|---|---|---|
| Deduct: | | |
| 9. Fire loss not charged off | $ 3,500.00 | |
| 10. Additional depletion allowed | 15,877.08 | |
| 11. Taxes paid not distributed | 6,193.34 | 25,570.42 |
| Corrected net income | | $184,953.31 |

Explanation of Adjustments to Net Income.

1. Interest receivable accrued has been added to income under Article 87 of Regulations 45.

2. Donations have been disallowed under Article 562 of Regulations 45.

3. Income tax accrued has been disallowed as a deduction under Article 131 of Regulations 45.

leb:3.

[64] North American Oil Consolidated.

4. Excessive depreciation has been computed as follows: Depreciation claimed $42,223.61, less depreciation allowed, $12,691.52, equals $29,532.09.

5. Wells rebuilt—cost of rebuilding has been disallowed as a deduction under Article 24 of Regulations 45.

6. Capital expenditures for engines have been disallowed under Article 24 of Regulations 45.

7. Contingent profit on 1914 sale, realized in 1918, has been added to income.

8. Drilling tools and machinery sold and proceeds credited to asset account have been restored to income.

9. Fire loss not charged off has been allowed as

a deduction from income under Article 141 of Regulations 45.

10. Additional depletion allowed has been computed as follows: Depletion allowed $183,392.56, less depletion claimed, $167,515.48, equals $15,877.08.

11. Taxes paid but not distributed on books have been deducted from income.

Invested Capital.

| | | | |
|---|---|---|---|
| Capital stock and surplus as shown by the balance sheets as at December 31, 1917 | | | $2,045,874.66 |
| Add: | | | |
| 1. | Paid in surplus account stock sales | $50,000.00 | |
| 2. | Organization expense | 20,000.00 | |
| 3. | Burned wells rebuilt | 5,271.50 | |
| 4. | Capital expenditures, (Casing, tubing, etc.) | 5,765.95 | |
| 5. | Depreciation charged off | 720,475.24 | |
| 6. | Depletion charged off | 459,566.29 | 1,261,078.97 |
| Total | | | $3,306,953.63 |
| Deduct: | | | |
| 7. | Income tax prorated, 1917 | $65,274.35 | |
| 8. | Tax withheld at source. | 64.20 | |
| 9. | Fire loss not charged off, 1917 | 1,646.19 | |
| 10. | Contingent profit realized, 1918 | 1,589.04 | |

| | | |
|---|---|---|
| 11. Depreciation allowed, prior years ..... | 307,412.95 | |
| 12. Depletion allowed, prior years ..... | 707,819.73 | |
| 13. Excess valuation of property ..... | 1,638,611.21 | 2,722,417.67 |
| Adjusted invested capital .. | | $ 584,535.96 |

leb:3

[65] North American Oil Consolidated.

Explanation of Adjustments to Invested Capital.

1. Paid in surplus (or appreciation of Section 16) has been allowed as recommended in Valuation Report dated July 30, 1925.

2. Organization expense charged off in 1910 has been restored to asset account.

3. Burned wells rebuilt disallowed as expense have been restored to asset account.

4. Capital expenditures (Casing, tubing, etc.) disallowed as expense have been restored to asset account.

5. Depreciation charged off has been restored account the corrected amount as shown under Item 11.

6. Depletion charged off has been restored for the reason that the corrected amount is shown under Item 12.

7. 1917 income tax $119,125.68 has been prorated and deducted under Article 845 of Regulations 45.

8. Tax withheld at source on bond interest,

being a liability, has been deducted from invested capital.

9. Fire loss not charged off has been allowed for 1917, and deducted from invested capital.

10. Contingent profit on 1914 sale realized in 1918 has been deducted from invested capital.

11. Depreciation allowed for prior years has been deducted from invested capital.

12. Excess valuation of property paid in for stock and bonds has been deducted from invested capital.

Computation of Tax—1918.

| | |
|---|---|
| Excess profits tax | $64,373.27 |
| 12% income tax | 14,229.60 |
| Total tax assessable | $78,602.87 |
| Original tax assessed | 16,374.21 |
| Deficiency in tax | $62,228.66 |

leb 3.

[66] North American Oil Consolidated.

1919.

Net Income.

| | | |
|---|---|---|
| Net Income reported in return | | $223,287.05 |
| Add: | | |
| 1. Donations disallowed | 112.00 | |
| 2. Excessive depletion disallowed | $64,058.06 | |
| 3. Capital expenditures (engines) | 5,049.28 | |

| | | |
|---|---|---|
| 4. Drilling tools and machinery sold | 3,627.55 | 72,846.89 |
| Total | | $296,133.94 |
| Deduct: | | |
| 5. Additional depreciation | $ 1,262.19 | |
| 6. Income tax accrued, error | 139.68 | 1,401.87 |
| Corrected net income | | 29 732.07 |

Explanation of Adjustments to Net I me:

1. Donations have been disallowed as a deduction under Article 562 of Regulations 45.

2. Excessive depletion has been computed as follows: Depletion claimed $324,987.28, less depletion allowed $260,929.22, equals $68,058.06.

3. Capital expenditures for engines have been disallowed under Article 24 of Regulations 45.

4. Drilling tools and machinery sold, same as Income, Item 8, for 1918.

5. Additional depreciation has been computed as follows: Depreciation allowed $9,769.49, less depreciation claimed on return, $8,507.30, equals $1,262.19.

6. Income taxes accrued per Schedule N, $20,879.90 less amount actually accrued on books, $20,740.22, equals $139.68, error in accrual.

Invested Capital.

| | |
|---|---|
| Capital stock and surplus shown by the balance sheets as at December 31, 1918 | $2,181,883.05 |

leb:3.

[67] North American Oil Consolidated.

| | | |
|---|---|---|
| Forward | | $2,181,883.05 |
| Add: | | |
| 1. Paid in surplus (stock sales in 1910) | $50,000.00 | |
| 2. Burned wells rebuilt, 1917 and 1918 | 12,367.91 | |
| 3. Organization expense, restored | 20,000.00 | |
| 4. Drilling tools and machinery restored | 6,516.10 | |
| 5. Capital expenditures prior years | 23,363.94 | |
| 6. Depreciation charged off | 762,698.85 | |
| 7. Depletion charged off | 627,081.77 | 1,502,028.57 |
| Total | | $3,683,911.62 |
| Deduct: | | |
| 8. 1918 income tax prorated | $33,217.57 | |
| 9. Additional tax for 1917 | 109,239.61 | |
| 10. Fire losses for 1917 and 1918 | 5,146.19 | |
| 11. Income tax not charged, 1918 | 4,205.81 | |
| 12. Depreciation allowed | 320,104.47 | |
| 13. Depletion sustained | 19,751.89 | |
| 14. Excess value of property | 1,638,611.21 | 2,930,276.75 |
| Adjusted invested capital | | $ 753,634.87 |

Explanation of Adjustments to Invested Capital.

1. Paid in surplus same as Invested Capital, Item (1) for 1918.

2. Burned wells rebuilt in 1917 and 1918, disallowed as expense for those years, have been restored.

3. Organization expense charged off in 1910, has been restored to asset account.

4. Drilling tools and machinery sold and credited to the asset account have been restored.

5. Capital expenditures for prior years disallowed as deductions from income have been restored to asset account under Article 24 of Regulations 45.

6. Depreciation charged off has been restored for the reason that the correct amount is shown under Item 12.

7. Depletion charged off has been restored for the reason that the correct amount is shown under Item 13.

8. 1918 income tax, $78,602.87, has been prorated and deducted under Article 845 of Regulations 45.

leb:3.

[68] North American Oil Consolidated.

9. Additional income tax for 1917 has been deducted under Article 131, of Regulations 45.

10. Fire losses for 1917 and 1918 not charged on books, having been allowed as deductions from income, have been deducted from invested capital.

11. Income tax paid in 1918, not distributed on the books, has been deducted from invested capital.

12. Depreciation allowed for prior years, same as invested capital, Item 11, for 1918.

13. Depletion sustained for prior years, same as invested capital, Item 12, for 1918.

14. Excess valuation of property paid in for stocks and bonds, same as invested capital, Item 13, for 1918.

Computation of Tax—1919.

| | |
|---|---|
| Excess profits tax | $75,089.28 |
| 10% income tax | 21,764.28 |
| Total tax assessable | $96,853.56 |
| Original tax assessed | 37,756.53 |
| Deficiency in tax | $59,097.03 |

leb 3.

[69] Depreciation Schedule.

| Property. | 1910. | 1911. | 1912. | 1913. | 1914. |
|---|---|---|---|---|---|
| 20% assets | $ 37,983.99 | $ 59,668.13 | $ 49,723.45 | $ 44,648.61 | $ 44,881.96 |
| 40% assets | 31,010.95 | 26,477.39 | 15,113.42 | 26,068.60 | 18,724.71 |
| F. W. and Section 14 | | | | 13,552.74 | 2,599.40 |
| Totals | $ 68,994.94 | $ 86,145.52 | $ 64,836.87 | $ 84,269.95 | $ 66,206.07 |
| F. W. and Section 14 | | | | 4,589.55 | 8,899.60 |
| Section 22 | 43,031.83 | 91,961.53 | 70,456.36 | 49,901.92 | 41,656.50 |
| Section 26 | 19,603.09 | 47,377.16 | 51,187.94 | 46,815.66 | 34,086.33 |
| Grand Total | $131,629.86 | $225,484.21 | $186,481.17 | $185,577.08 | $150,848.50 |
| Accumulated Total | 13,629.86 | 357,114.07 | 843,595.24 | 729,172.32 | 880,020.82 |

| Property. | 1915. | 1916. | 1917. | 1918. | 1919. |
|---|---|---|---|---|---|
| 20% assets | $ 23,917.22 | $ 15,801.94 | $ 12,496.47 | $ 9,665.42 | $ 7,714.59 |
| 40% assets | 9,396.35 | 5,061.99 | 1,420.97 | 3,026.10 | 2,054.90 |
| Totals | $ 33,313.57 | $ 20,863.93 | $ 13,917.44 | $ 12,691.52 | $ 9,769.49 |
| F. W. and | | | | | |
| Section 14 | | | | | |
| Section 22 | | | | | |
| Section 26 | $ 23,830.09 | | | | |
| Grand Total | $ 57,143.66 | $ 20,863.93 | $ 13,917.44 | $ 12,691.52 | $ 9,769.49 |
| Accumulated Total | $937,164.48 | $958,028.41 | $307,412.95 | $320,104.47 | $329,873.90 |
| Accumulated total on property sold and abandoned | | 664,532.90 | | | |
| Accumulated depreciation revised | | $293,495.51 | $307,412.95 | $320,104.47 | $329,837.90 |

Your claim for the credit of $5,929.70, part of the tax assessed for 1918, will be rejected in a schedule to be approved by the Commissioner.

The information contained in the returns, claim for credit and revenue agent's report, has been carefully considered in determining the tax liability as set forth herein.

Payment of the deficiency in tax should not be made until a bill is received from the Collector of Internal Revenue for your district and remittance should then be made to him.

Now, November 6, 1930, the foregoing petition certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[70] Filed Jun. 24, 1926. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 16,107.

NORTH AMERICAN OIL CONSOLIDATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ANSWER.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for answer to the petition of the

above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph 1 of the petition.

(2) Admits the allegations contained in paragraph 2 of the petition.

(3) Admits the allegations contained in paragraph 3 of the petition.

(4) (a) Admits that certain of taxpayer's oil derricks were damaged by fire in 1918 and that the cost of repairing and replacing them was $7,095.41, but denies that this amount constitutes an allowable deduction from gross income for said year.

(b) Admits that the taxpayer purchased certain gasoline engines during 1918 for the sum of $17,598.00 and purchased other gasoline engines in 1919 for the sum of $5,049.28, and admits that respondent disallowed a deduction of the respective amounts in each of the aforesaid years on the ground that they represented capital expenditures rather than ordinary and necessary business expenses, but denies that this was error.

(c) Admits that respondent added to petitioner's taxable income for the year 1918 the sum of $1,589.04, which sum represents a contingent profit realized in 1918, but denies that this was error.

(d) Denies that the taxpayer is entitled to a deduction for depletion on its oil properties in the year 1918 in any amount in excess of $183,392.56 as allowed by the Commissioner.

[71] Re: Appeal of North American Oil Consolidated, No. 16,107.

(e) Denies that the taxpayer is entitled to a deduction for depletion on its oil properties in 1919 in any amount in excess of $260,929.22 as allowed by the Commissioner.

(f) Admits that the Commissioner reduced petitioner's invested capital in 1918 by the sum of $707,819.73 and for 1919 in the sum of $819,751.89, but denies that this was error.

(g) Admits that the Commissioner reduced taxpayer's invested capital for 1918 in the amount of $65,274.34, which sum represents additional income and profits taxes for 1917, prorated, but denies that this was error.

(h) Admits that Commissioner reduced petitioner's invested capital for the calendar year 1919 in the sum of $33,217.50, which sum represents 1918 income taxes prorated over the year 1919, but denies that this was error.

(i) Admits that Commissioner reduced petitioner's invested capital for the calendar year 1919 in the amount of $109,239.61, which sum represents additional taxes for the calendar year 1917, but denies that this was error.

(j) Admits that Commissioner reduced petitioner's invested capital in the amount of $1,589.04, which sum represents the profit realized in 1918 on a contingent sale, but denies that this was error.

(k) Admits that Commissioner reduced petitioner's invested capital for the calendar year 1918 in the amount of $1,646.19, which sum represents a fire loss in 1917, but denies that this was error.

(l) Admits that Commissioner reduced petitioner's invested capital rfo the calendar year 1918 in

the amount of $5,146.19, which sum represents fire losses for 1917 and 1918, but denies that this was error.

(m) Admits that Commissioner reduced petitioner's invested capital for each of the years 1918 and 1919 by the sum of $1,638,611.21, but denies

[72] Re: Appeal of North American Oil Consolidated, No. 16,107.

that the properties acquired for stock and bonds had an actual cash value in excess of the amount allowed by the Commissioner.

(5) Denies all allegations of the petition not hereinbefore specifically admitted or denied.

WHEREFORE, it is prayed that the appeal be denied.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

A. GEORGE BOUCHARD,
Special Attorney,
Bureau of Internal Revenue.

Now, November 6, 1930, the foregoing answer certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[73] Filed Jan. 25, 1927. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 16,107.

NORTH AMERICAN OIL CONSOLIDATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

## AMENDED ANSWER.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for amended answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph 1 of the petition.

(2) Admits the allegations contained in paragraph 2 of the petition.

(3) Admits the allegations contained in paragraph 3 of the petition.

(4) (a) Admits that certain of taxpayer's oil derricks were damaged by fire in 1918 and that the cost of repairing and replacing them was $7,095.41, but denies that this amount constitutes an allowable deduction from gross income for said year.

(b) Admits that the taxpayer purchased certain gasoline engines during 1918 for the sum of $17,598.00 and purchased other gasoline engines in 1919 for the sum of $5,049.28, and admits that respondent disallowed a deduction of the respective amounts

in each of the aforesaid years on the ground that they represented capital expenditures rather than ordinary and necessary business expenses, but denies that this was error.

(c) Admits that respondent added to petitioner's taxable income for the year 1918 the sum of $1,589.04, which sum represents a contingent profit realized in 1918, but denies that this was error.

[74] Re: North American Oil Consolidated, No. 16,107.

(d) Denies that for the years 1918 and 1919 the petitioner is entitled to deductions from income on account of depletion of oil properties located in Section 16, Township 32 South, Range 23 East, M. D. M., Kern County, California, in excess of the amounts allowed by the Commissioner.

(e) Admits the Commissioner allowed depletion deductions on account of depletion of oil wells located on Section 2, Township 32, Range 23 East, M. D. M., Kern County, California, as alleged in paragraph 5(f) and 5(g) of the petition.

(f) Alleges the Commissioner erred in allowing depletion deductions based upon discovery value of oil wells located on Section 2, Township 32 South, Range 23 East, M. D. M., Kern County, California.

(g) Admits that the Commissioner reduced petitioner's invested capital in 1918 by the sum of $707,819.73 and for 1919 in the sum of $819,751.89, but denies that this was error.

(h) Admits that the Commissioner reduced taxpayer's invested capital for 1918 in the amount of $65,274.34, which sum represents additional income

and profits taxes for 1917, prorated, but denies that this was error.

(i) Admits that the Commissioner reduced petitioner's invested capital for the calendar year 1919 in the sum of $33,217.50, which sum represents 1918 income taxes prorated over the year 1919, but denies that this was error.

(j) Admits that the Commissioner reduced petitioner's invested capital for the calendar year 1919 in the amount of $109,239.61, which sum represents additional taxes for the calendar year 1917, but denies that this was error.

(k) Admits that the Commissioner reduced petitioner's invested capital in the amount of $1,589.04, which sum represents the profit realized in 1918 on a contingent sale, but denies that this was error.

[75] Re: North American Oil Consolidated, No. 16,107.

(l) Admits that the Commissioner reduced petitioner's invested capital for the calendar year 1918 in the amount of $1,646.19, which sum represents a fire loss in 1917, but denies that this was error.

(m) Admits that the Commissioner reduced petitioner's invested capital for the calendar year 1919 in the sum of $5,146.19, which sum represents fire losses for 1917 and 1918, but denies that this was error.

(n) Admits that the Commissioner reduced petitioner's invested capital for each of the years 1918 and 1919 by the sum of $1,633,611.21 but denies that the properties acquired for stock and bonds had an actual cash value in excess of the amount allowed by the Commissioner.

(o) Alleges that the Commissioner erred in the determination of the petitioner's net income for the year 1918 by allowing as a deduction from income the sum of $21,730.60 paid to attorneys for legal services in perfecting the taxpayer's title to a portion of its properties, and alleges that said sum so paid was a capital expenditure.

(p) Alleges the Commissioner erred in the determination of the petitioner's net income for the year 1919 by allowing as a deduction from income the sum of $35,795.54 paid to attorneys for legal services in perfecting the taxpayer's title to a portion of its properties, and alleges that said sum so paid was a capital expenditure.

(5) Denies all allegations of the petition not hereinbefore expressly admitted or denied.

WHEREFORE, it is prayed that the appeal be denied, and that the deficiencies for the years 1918 and 1919 as set forth in deficiency letter dated April 9, 1926, be increased respectively.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

A. GEORGE BOUCHARD,
Special Attorney,
Bureau of Internal Revenue.

Now, November 6, 1930, the foregoing amended answer certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

[76] Filed at Hearing May 2, 1927.

United States Board of Tax Appeals.

DOCKET No. 16,107.

NORTH AMERICAN OIL CONSOLIDATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

AMENDMENT TO AMENDED ANSWER.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, General Counsel, Bureau of Internal Revenue, for amendment to amended answer to petition of the above-named taxpayer, alleges as follows:

That respondent erred in determining petitioner's invested capital and depletion deductions for the years 1918 and 1919 by adding to capital sum remaining in 1916 the sum of $287,687.03 representing the capitalized cost of well development on Section 16, Township 32 South, Range 23 East, during the year 1916, whereas in truth and in fact said sum was expended in drilling wells during the years 1910 and 1911 as follows: $51,727.64 in the year 1910 and $235,959.39 in the year 1911; that said sum of $287,687.03 should have been added to the capital sum during the years 1910 and 1911 instead of the year 1916; that petitioner's invested capital for the year 1918 as shown in deficiency letter dated April

9, 1926, should be decreased in the sum of $120,706.22 and that the depletion allowance for the year 1918 as shown in said letter should be reduced by the sum of $8,285.60; that petitioner's invested capital for the year 1919 as shown in said deficiency letter should be decreased in the sum of $112,420.62 and depletion allowance for the year 1919 as shown in said letter should be reduced by the sum of $8,029.67.

A. W. GREGG,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
A. GEORGE BOUCHARD,
Special Attorney,
Bureau of Internal Revenue.

Now, November 6, 1930, the foregoing amendment to amended answer certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[77] A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET Nos. 8714 and 16,107.

Promulgated May 24, 1928.

NORTH AMERICAN OIL CONSOLIDATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Assessment and collection of taxes for 1917 held not barred by statute of limitations.

Deduction claimed for an amount paid Oil Industry Association disallowed for lack of evidence.

Cost of replacing derricks damaged by fire held not deductible as expense.

Portion of proceeds of oil paid attorneys for legal services in defending title to property and securing land patents, held to be capital expenditures. Further held that depletion is allowable in each year in amounts equal to the sums paid to the attorneys.

Respondent sustained in disallowing deductions claimed on account of expenditures in 1918 and 1919 for gasoline engines.

Value of petitioner's land holdings in one section for invested capital and depletion purposes determined; and quantity of oil reserves for depletion purposes determined.

Respondent sustained in reduction of invested capital on account of fire losses, depletion, and taxes for prior years, subject to correction of amounts to reflect changes effected by this decision.

Income in 1916 impounded by court order and released to petitioner in 1917 held not taxable to petitioner in 1917.

Capital expenditures made in 1910 and 1911 should be reduced to reflect depletion before inclusion in capital sum remaining in 1916 for purposes of computing invested capital and depletion for 1917 and subsequent years.

CHARLES D. HAMEL, Esq., and LEE I. PARK, Esq., for the Petitioner.

A. GEORGE BOUCHARD, Esq., for the Respondent.

[78] In this proceeding the petitioner seeks a redetermination of the income and profits taxes for the years 1917, 1918 and 1919, for which the Commissioner has determined deficiencies of $109,239.61, $62,228.66 and $59,097.03, respectively.

The petitioner alleges error on the part of the Commissioner:

(1) In proposing an additional tax for the year 1917, after the assessment and collection of such tax was barred by the statute of limitations provided by section 250(d) of the Revenue Act of 1921 and section 277 of the Revenue Act of 1924.

(2) In disallowing as a deduction in 1917 $8,000 paid to the Oil Industry Association.

(3) In disallowing as deductions amounts spent for the repair and replacement of oil derricks dam-

aged by fire as follows: 1917, $5,271.50; 1918, $7,096.41.

(4) In including in taxable income for 1917 $20,441.18, representing four per cent of the oil recovered during the year from Section 2, and paid to the petitioner's attorneys for legal services in defending title to property.

(5) In disallowing as expense for the year 1917 $5,765.94 spent for gas pumping engines, sucker rods, small receiving oil tanks, well casing and tubing, and for the year 1918, $17,598 and for the year 1919 $5,049.28 expended for gasoline engines used in operating the pumps at the various oil-wells.

(6) In determining inadequate amounts as depletion deductions for 1917, 1918 and 1919 on account of oil extracted during such years from Section 16, Township 32 South, Range 23 East. This issue involves the determination of the value of the oil deposit in Section 16 at March 1, 1913.

[79] (7) In reducing invested capital for 1917 in an amount of $33,882.51 and in 1918 in an amount of $1,589.04, representing profits realized in 1917 and 1918 on a 1914 contingent sale.

(8) In reducing invested capital for 1918 in an amount of $1,646.19 and for 1919 in an amount of $5,146.19, representing fire losses in 1917 and 1918, respectively.

(9) In reducing invested capital on account of depletion sustained during prior years by the following amounts: 1917, $602,820.96; 1918, $707,819.73; 1919, $819,751.89.

(10) In reducing invested capital for 1918 in

an amount of $65,274.34 and for 1919 in an amount of $33,217.57, representing additional taxes for the previous year, pro rated over the taxable year.

(11) In reducing invested capital in all years by $1,638,611.21, representing excess valuation of property. This issue involves the determination of the value of property acquired for stock and bonds on February 10, 1910, and August 25, 1910.

The Commissioner, in his answers to the various petitions and amendments thereto, alleges affirmatively:

(a) That he erred in failing to exclude as taxable income in 1917 an amount of $253,150.96 received by the petitioner in that year, representing the revenue derived from Section 2, Township 32 South, Range 23 East, which amount was impounded during the litigation between the petitioner and the United States in 1916 and 1917 and released in 1917.

(b) That he erred in determining invested capital and depletion allowance for 1917 by adding to the capital sum remaining in 1916 the amount of $287,687.03, representing the cost of well development on Section 16, during 1916, whereas this amount was expended as follows: 1910, [80] $51,727.64; 1911, $235,959.39; that the additions to capital should have been made in 1910 and 1911 in the amounts thus expended instead of 1916; that the invested capital for 1917 as shown in deficiency letter dated September 28, 1925, should be decreased by $131,930.22, and that the depletion allowance for 1917 as shown by said deficiency letter should be reduced by $11,224.00, that the invested capital for

1918 and 1919 as shown by the deficiency letter of April 9, 1926, should be decreased by $120,706.22 and $112,420.62, respectively, and that the depletion allowances for 1918 and 1919 as shown by said letter should be reduced by $8,285.60 and $8,029.67, respectively.

(c) That he erred in allowing depletion deductions in 1918 and 1919 based upon discovery value of oil-wells located in Section 2, Township 32 South, Range 23 East.

(d) That he erred in allowing as a deduction for 1918 $21,730.60 and for 1919 $35,795.45 paid to attorneys for legal services in perfecting title to a portion of the petitioner's property and alleges that the sums paid were capital expenditures.

At the hearing the petitioner conceded and abandoned issue number (7) and the respondent conceded and abandoned his affirmatve allegation designated issue (c).

## FINDINGS OF FACT.

The petitioner is a corporation organized in 1910 under the laws of the State of California with principal office at 915 Balfour Building, San Francisco, California.

On February 10, 1910, the petitioner acquired from Louis Titus in exchange for 82,500 shares of capital stock of a par value of $8,250,000 and $825,000 face value of bonds, certain properties in accordance with a resolution adopted by the directors in a meeting of February 10, 1910. [81] The portions of the resolution dealing with the lands involved in this proceeding were as follows:

WHEREAS, Louis Titus has offered to sell and to convey to this corporation, free and clear of all encumbrances, the following lands situate, lying and being in the County of Kern, State of California, described as follows, to wit:

North half of Northeast quarter of Southeast quarter (N.½ of NE.¼ of SW.¼), South half of Southwest quarter (S.½ of SW.¼) of Section Sixteen (16);

* * * * * * * * * *

and to sell and convey to this corporation all his interest in the following lands, situate in the County of Kern, State of California, described as follows, to wit:

The South half of Southeast quarter (S.½ of SE.¼); Northwest quarter of Southeast quarter (NW.¼ of SE.¼); South half of Northeast quarter (S.½ of NE.¼ of Southeast quarter (SE.¼); South half of Southwest quarter of Northeast quarter (S.½ of SW.¼ of NE.¼); South five (5) acres of North half of Southwest quarter of Northeast quarter (N.½ of SW.¼ of NE.¼); North half of Southwest quarter (N.½ of SW.¼), of Section Sixteen (16);

* * * * * * * * *

East half of Northeast quarter (E.½ of NE.¼); Northwest quarter of Northeast quarter (NW.¼ of NE.¼); North fifteen (15) acres of North half of Southwest quarter of

Northeast quarter (N.½ of SW.¼ of NE.¼), in Section Sixteen (16);

* * * * * * * * *

All in Township Thirty-two (32) South, Range Twenty-three (23) East, Mount Diablo Base and Meridian; and to sell to this corporation all personal property and equipment now upon and used in connection with, or in the operation of, said lands or leases, or any part thereof; all in consideration of the issuance to said Louis Titus of Eighty-two Thousand Five Hundred (82,500) shares of the capital stock of this corporation, fully paid up, and the delivery to him of First Mortgage Six Per Cent Gold Bonds of this corporation aggregating Eight Hundred and Twenty-five Thousand ($825,000) Dollars, in par value of said bonds, which bonds are to be secured by a First Mortgage on the lands and leases so conveyed by said Louis Titus; and in further consideration of the assumption by this corporation of all obligations of the leases so offered to be assigned, and of the assumption by this corporation of liability for all unpaid bills incurred for labor or material used upon any of said lands or leases, and in further consideration of the assumption by this corporation of all bills and obligations of Hartford Oil Company, a corporation, which bills and obligations have heretofore been assumed by said Louis Titus.

[82] Part of the obligations assumed by the petitioner represented the balance of the purchase

price still owing upon certain of the lands described above.

On August 25, 1910, the petitioner purchased the fee to 135 acres in the Northeast quarter (NE.¼) of Section Sixteen (16), of which land the petitioner was lessee, in accordance with a resolution adopted in a meeting of the Board of Directors on August 10, 1910, which reads as follows:

> RESOLVED, that this corporation purchase from Lockwood Company, a corporation, all the right, title and interest now owned or claimed by said Lockwood Company in or to the Northeast quarter and the South half of Section 16, in Township 32 South, Range 23 East, M. D. B. and M., including the remainder in fee owned by said company in about one hundred and thirty-five (135) acres in the Northeast quarter of said Section, a claim to an interest in fee in a triangular piece of land along the southerly boundary of the Southeast quarter of said Section, and an undivided one-half interest in two strips of land along the Southerly and Westerly boundary lines of the Southwest quarter of said Section and that with said lands, this corporation purchase a release from any and all obligations to said Lockwood Company incurred by it under all leases of lands of which this company is lessee in said Section 16, and also purchase a release of all its obligations of every kind now owned or held by or owing to said Lockwood Company, except the promissory note of this cor-

poration, dated May 17, 1910, for the sum of $38,116.25, and that in consideration of the transfer of said interests in land and of the release of said obligations by said Lockwood Company to this corporation, this corporation pay to said Lockwood Company the sum of $2,244.50 and deliver to said Lockwood Company bonds of this corporation aggregating $200,000 in face value thereof, and also issue and deliver to said Lockwood Company 2000 shares of the capital stock of this corporation.

On March 1, 1909, Louis Titus, acting on behalf of the Hartford Oil Company, one of the predecessors of the petitioner, acquired from the Lockwood Company an option to purchase for $180,000 the West ½ of the SE.¼, containing about 80 acres of land; the NE.¼ of the SE.¼, containing about 40 acres of land; the S.½ of the S.½ of the NE.¼, containing about 40 acres of land, all in Section 16, Township 32 South, Range [83] 23 East, M. D. B. & M. By the same agreement, Titus also acquired for the Hartford Oil Company an option to lease from the Lockwood Company the N.½ of the NE.¼, containing about 80 acres, and the N.½ of the S.½ of the NE.¼, containing about 40 acres, all in Section 16, Township 32 South, Range 23 East, M. D. B. & M.

On June 1, 1909, the option of March 1, 1909, was exercised by Titus, acting on behalf of the Hartford Oil Company.

On July 20, 1909, the Hartford Oil Company ac-

quired the SE.¼ of the SE.¼ of Section 16, Township 32 South, Range 23 East.

On November 27, 1909, the contract of March 1, 1909, was revised in the following particulars:

> Whereas, the parties now desire to modify said agreement, it is now therefore agreed, that there shall be released from said agreement of sale, the following described property, to wit:
>
> "The North half (½) of the Northeast quarter (¼) of the Southeast quarter (¼) of said Section, and also the South half (½) of the Southeast quarter (¼) of the Northeast quarter (¼) of said Section";
>
> and said land shall not be purchased by the party of the second part, but shall be retained by the party of the first part. The purchase price of the entire one hundred and sixty (160) acres agreed to be purchased, shall be reduced at the rate of Eleven hundred and twenty-five ($1,125.00) dollars per acre for each acre above released from said contract.
>
> It is further agreed, that the party of the first part will sell to the party of the second part, and the party of the second part will buy from the party of the first part, the North half (½) of the Southwest quarter (¼) of said Section Sixteen (16), and pay therefor the sum of Eleven hundred and twenty-five ($1,125.00) dollars per acre. The party of the second part will also buy from the party of the first part a strip of land along the South side of and being a portion of the North

half (½) of the Southwest quarter (¼) of the Northeast quarter (¼) of said Section, which strip of land shall be sufficient in width to contain five (5) acres of land and shall include the present well and buildings now understood to be upon said five (5) acres. If, upon a survey, it should be determined that a wider strip of [84] land is needed in order to include said well, and said buildings, then said strip of land shall be wide enough in any event to include said well and said buildings, and the party of the second part will pay therefor at the rate of eleven hundred and twenty-five ($1,125.00) dollars per acre.

It is further understood and agreed, that the lease now held by the party of the second part upon the One hundred and twenty (120) acres of land in said Section, shall be cancelled and annulled, but that the party of the second part shall receive from the party of the first part a lease upon the West half (½) of the Northeast quarter (¼) of said Section, save and except such portions of said land as have heretofore or herein agreed to be sold to said second party. Said lease shall be upon the terms and conditions of said original lease for said One hundred and twenty (120) acres, save and except that the party of the second part shall be required to keep in operation only one string of tools on said property, and shall be allowed Ninety (90) days from date in which to commence operation upon the first well on

said lease, and the party of the second part shall not be required to drill more than One (1) well to each four (4) acres of said leased land.

It is further understood and agreed that inasmuch as there is an apparent shortage in said Section, that all payments and settlements under this and the previous agreement between the parties hereto, shall be adjusted according to the Buffington Survey, it being understood, however, that in the event that the party of the first part can, within two (2) years from the date hereof, deliver the full amount of land called for in said contracts, or any land in addition to the Buffington Survey, and can make up said shortage by adding to the Southerly line of the Southeast quarter (¼) of said Section, and/or adding to the Westerly line of the North half (½) of the Southwest quarter (¼) of said section, that then, and in that event, the party of the second part shall be bound to accept said additional acreage and pay therefor at the rate of Eleven Hundred and Twenty-five ($1,125.00) Dollars per acre.

It is further understood that all sums due under this and the previous contract between the parties hereto shall be paid at the rate of Ten Thousand ($10,000) Dollars on December 1, 1909, and the balance at the rate of Five Thousand ($5,000) Dollars per month, payable on the first day of each and every month until the entire sum is paid, and that deferred pay-

ments shall bear interest at the rate of Six per cent (6%) per annum, payable monthly, said interest to begin for the additional land purchased under this contract on the first day of December, 1909."

On February 3, 1910, Louis Titus, acting on behalf of the Louis Titus Pool, leased from the Lockwood Company the E.½ of the NE.¼, the NW.¼ of the NE.¼ and the North 15 acres more or less of the N.½ of the SW.¼ [85] of the NE.¼. The lessor retained one-fifth of all money received from the sale of oil.

On February 4, 1910, Louis Titus, acting on behalf of the Louis Titus Pool, purchased from the Lockwood Company the N.½ of the NE.¼ of the SE.¼ of Section 16, Township Thirty-two South, Range 23 East, M. D. B. & M., containing twenty (20) acres of land, more or less, for $30,000.

The record does not show the date of purchase of the S.½ of the SW.¼ of Section 16, Township 32 South, Range 23 East, M. D. B. & M. It was, however, turned over to the petitioner on February 10, 1910, and the petitioner does not contend that it was acquired by the Hartford Oil Company prior to that date. It was acquired at a total cost of $78,480.00. The oil possibilities in a portion of it at that time were doubtful.

The costs of the lands in Section 16, Township 32 South, Range 23 East, which were acquired by the petitioner on February 10, 1910, to the predecessors of the petitioner were as follows:

| | Cost. |
|---|---|
| Hartford Oil Co., Fee SE.¼ of SE.¼ | $ 42,000.00 |
| Hartford Oil Co., Fee N.½ of SW.¼ W.½ of SE.¼; S.½ of NE.¼ of SE.¼; S.½ of SW.¼ of NE.¼; 5.5 acres of N.½ of SW.¼ of NE.¼ | 205,616.25 |
| Hartford Oil Co., Lease S.½ of SW.¼ | 10,000.00 |
| Louis Titus Pool, Fee S.½ of SW.¼ | 68,480.00 |
| Louis Titus Pool, Fee N.½ of NE.¼ of SE.¼ | 30,000.00 |
| Louis Titus, Lease, N.½ of NE.¼; N.½ of SE.¼ of NE.¼; 15 acres of N.½ of SE.¼ of NE.¼ | Nothing |
| Total | $356,096.25 |

The petitioner did not acquire a small area in the northwest corner of the SW.¼, nor a small area in the southwest corner of the SW.¼ of Section 16.

[86] At the time Section 16 was acquired by the petitioner, the geological structure of the district had been worked out and the existence of oil-bearing sands established. It was apparent that an anticlinical axis crossed the southwestern portion of Section 16, and extended for several miles northwest and southeast. From a geological point of view Section 16 was favorably situated for the accumulation of oil in the underlying sands. The development northwest and southeast of Section 16 established that there existed in those sections a zone or streak in the sands which contained a lighter and more valuable oil than was found to the southwest in the foothills. Persons interested in the field generally believed that this streak or zone

extended from the middle of Section 30, Township 32, Range 24, southeastward into the Maricopa District and northwestward across Sections 14, 10, 15, the northeast portion of 16, 9, portions of 5, and Section 6 in Township 32, Range 23, and thence northwest across Section 31, Township 31, Range 23, and Sections 24, 25 and 36 of Township 31, Range 22. Several wells were drilled in this zone, of the highly productive type called "gushers," which resulted in naming this zone the "gusher zone."

Prior to February, 1910, a few wells had been drilled on Section 16. Four wells were drilled in the SW.¼. These wells struck oil but the production from them, if there was any at all, was inconsequential. These wells appeared to represent the southwest margin of profitable development and indicated that the prospect of striking oil in the southwest quarter was rather doubtful. One well was drilled southwest of the center of the Northeast ¼, which showed lots of oil but so much water was mixed with the oil that there was no commercial production. Two wells were drilled in the SE.¼. Well No. 2 produced about 100 bbls. a day and Well No. 3 about 200 bbls. a day. These wells were near the west line in the SW.¼ of the SE.¼.

[87] A number of wells had been drilled in the NE.¼ of Section 17, and in Sections 8, 22, 23 and 26, which encountered the oil-bearing sands between sea level and an elevation of 500 feet above sea level. A large part of Section 16 shows the oil-bearing sands at the same elevation. A well

was drilled in the center of Section 9, Township 32, Range 23, in October, 1909, by the C. C. M. O. Company. A "showing" of oil only resulted. This well encountered the oil sand at about 600 feet below sea level.

A well was drilled in the southwest corner of the northwest ¼ of Section 15, known as the Jade, encountering the sand some 300 feet below sea level. A well was drilled in the SW.¼ of Section 14, known as the Bedrock, encountering the sand about 800 feet below sea level. In September, 1909, the Standard Oil Company brought in a good well in Section 14, Township 32, Range 23, encountering the sand about 1200 feet below sea level.

In November, 1909, the St. Lawrence Oil Company drilled a well in the southwest corner of the SE.¼ of Section 5, Township 32, Range 23, that produced about 500 bbls. a day, encountering the oil sands approximately at sea level.

In November, 1909, the C. C. M. O. Company drilled a well in Section 6, Township 32, Range 23, which produced 1,000 barrels a day. At the well the oil sand was encountered at approximately 500 feet above sea level.

Other wells drilled prior to February 10, 1910, were as follows:

| Date | Description. | Designation. | Remarks. |
|---|---|---|---|
| April 1909 | Sec. 7, T. 12, R. 25 | Lady Washington | Showing of oil |
| July 1909 | Sec. 10, T. 32, R. 24 | | Gasser |
| Oct. 1909 | Sec. 14, T. 31, R. 22 | Bear Creek | Considerable heavy oil |
| 1909 | Sec. 30, T. 32, R. 24 | Standard Oil | Showing of oil |
| Nov. 1909 | Sec. 36, T. 12, R. 24 | Wellman | Large well |
| Jan. 1910 | Sec. 35, T. 32, R. 23 | Hamilton #1 | Commercial producer |
| June 1909 | Sec. 31, T. 31, R. 23 | Crandall #1 | Large producer |
| Sept. 1909 | Sec. 31, T. 31, R. 23 | Crandall #2 | Production |
| Oct. 1909 | Sec. 31, T. 31, R. 23 | #2 Midway Crude | 406 bbls. a day |

[88] At this time it was known that numerous anticlines, and cynclines had resulted from the folding of the oil sands, causing many abrupt changes in the dip of the sands, within short distances. The Spellacy Hill anticline extended from Section 18, Township 32, Range 23 southeast to Section 32, Township 32, Range 24, and possibly further. Another anticline was located crossing the southwestern portion of Section 6, Township 32, Range 23, and extending into Township 31, Range 22 and a third was located from Section 35, Township 32, Range 23, southeast to Section 11, Township 11 North, Range 24 West. These were all minor folds in the McKittrick formation which as a whole was tilted to the northeast.

In March, 1910, the Lakeview gusher came in on Section 25, Township 12, Range 24, and produced from 40,000 to 70,000 barrels a day. This well encountered the oil sands at approximately 1400 feet below sea level.

In May, 1910, the Regal #1 gusher came in on the NW.¼, Section 14, Township 32, Range 23. This well encountered the oil sands at a depth of approximately 1300 feet.

In May, 1910, a 6,000 barrel well came in on Section 30, Township 31, Range 23. This well encountered the oil sands at a depth of more than 1100 feet below sea level.

Between February 10, 1910, and March 1, 1913, three wells were drilled in the northeast quarter of Section 16. Well number 67, located in the northwest corner produced 100 barrels a day and well

number 71, in the northeast corner produced about 50 barrels a day. Well No. 67 was considered a profitable well. About eleven wells were drilled in the SW.¼, of which two were water wells, and one, Number 34, produced on an average 300 barrels a day, and sixteen wells were drilled on the SE.¼, one of which was a water well. The wells which were abandoned prior to March 1, 1913, were Nos. 1, 4, 5, 47 and 48, in the SW.¼, Nos. 4, 7 and 19 in the SE.¼.

[89] At Well No. 71 the oil sand is shown to be approximately 700 feet below sea level and at Well No. 67 approximately 300 feet below sea level.

*At* March 1, 1913, numerous wells had been drilled within the so-called "gusher zone" between Section 30, Township 32, Range 24 and Section 31, Township 31, Range 23. Between Well No. 2 of Section 6, Township 32, Range 23 and the southeast corner of Section 5, some 35 producing wells were drilled, one of which was called a gusher and produced 500 barrels a day. Eight producing wells drilled in Section 9 had a showing of oil. In Section 16, four wells were drilled, one producing 100 barrels a day, and one 50 barrels a day. In Section 10, eleven wells were drilled, one of which was designated a producer. In Section 15, some fourteen wells were drilled, scattered over the section; the majority of which proved to be producers. In Section 14, fifteen producing wells were drilled, one of which, the Regal #1, was a gusher. In Section 23 approximately twenty producing wells were drilled. In Section 24, twenty producing wells

were drilled. In Section 30, Township 32, Range 24, four producing wells are of record, of which one well was a "gusher."

The production by years from Section 16 during the period from 1910 to 1919, both inclusive, was as follows:

Section 16.

| Year. | Production in Bbls. |
|---|---|
| 1910—Feb.—Dec. | 86,434 |
| 1911 | 425,083 |
| 1912 | 580,775 |
| 1913 (1/1–3/1) | 84,513 |
| 1913 (3/1–12/31) | 308,828 |
| 1914 | 315,130 |
| 1915 | 193,832 |
| 1916 | 176,509 |
| 1917 | 144,675 |
| 1918 | 106,799 |
| 1919 | 103,500 |

[90] The production by years from Section 22, during the period from 1910 to October 31st, 1915, was as follows:

Section 22.

| Year. | Production in Bbls. |
|---|---|
| 1910 | 628,291.94 |
| 1911 | 1,342,504.05 |
| 1912 | 1,028,559.95 |
| 1913 | 728,495.22 |
| 1914 | 608,124.19 |
| 1915 (1/1–10/31) | 285,390.26 |

The production by years from Section 26 during the period from 1910 to October 31st, 1916, was as follows:

Section 26.

| Year. | Production in Bbls. |
|---|---|
| 1910 | 153,508.90 |
| 1911 | 371,003.64 |
| 1912 | 400,845.27 |
| 1913 | 366,606.62 |
| 1914 | 266,925.06 |
| 1915 | 186,609.95 |
| 1916 (1/1–10/31) | 133,499.25 |

Testimony was given as to various sales of oil properties. In December 1908, Barlow sold eight acres in Section 25, Township 32, Range 23, for $25,000 cash. At the time of the sale there was no development on that tract. The line of strike had not been definitely established. Production had been obtained on Section 25.

In January, 1908, M. J. Laymance gave a lease on 20 acres in Section 19, Township 30, Range 22, with option to purchase in fee until January 1, 1909, for $3,000 an acre. This option was exercised. In January, 1908, there were no wells on the property but there were producing wells on the adjoining Section 20. This property was from 16 to 18 miles from Section 16, owned by the petitioner.

[91] In April, 1909, Laymance bought the NW.¼ and SE.¼ of Section 36, Township 12, Range 24, for $160,000, a rate of $500 an acre. No

wells were on the property and the nearest development was in Section 1, about a mile distant. Later the NW.¼ of the NW.¼ sold for $80,000, of which 20 acres were later sold for $3,000 an acre.

In the latter part of 1909, or the first part of 1910, Laymance purchased a leasehold on 320 acres in Section 20, Township 31, Range 23, with an option to purchase the fee. He exercised the option and later within the year while drilling sold the property for $2,000 an acre.

In the latter part of 1909 Laymance purchased a Government location on all of Section 2, T. 32, S., R. 23 E., for $128,000.

There was sold in June, 1910, 480 acres in Section 30, Township 31, Range 23, for $1,500,000 cash and $1,500,000 face value of Associated Oil bonds. Just prior to this sale in May, 1910, a well came in on this property producing 6,000 to 7,000 barrels a day.

In September, 1910, the lessor's twenty per cent interest in 40 acres of Section 2, Township 11, Range 24, was sold for $300,000. Prior to this sale the Lakeview gusher came in and was instrumental in consummating this sale.

W. H. Cooley purchased 160 acres of unpatented land consisting of the E.½ of SW.¼ and W.½ of the SE.¼, Section 31, Township 31, Range 23, in December, 1908, at $2,000 an acre. In December, 1909, he sold the North 80 acres at $3,000 an acre. At the time of this sale a well had been drilled on the South 80 acres producing 406 barrels a day and

the spectacular gusher in Section 6, Township 32, Range 23, had been completed.

S. G. Tryon and associates sold 20 acres of patented land in the NW.¼ of the NW.¼ of Section 36, Township 12, Range 24, in November, or December, 1909, for $3,000 an acre.

[92] In June, 1910, 160 acres of unpatented land being the S.½ of the S.½ of Section 32, Township 31, Range 23, was sold for $1,500 an acre.

In the summer of 1910 there was sold unpatented land in the NW.¼ of Section 32, Township 32, Range 24, as follows: 20 acres W.½ of NW.¼ of NW.¼ for $4,000 an acre; 40 acres SW.¼ of NW.¼ at $3,000 or $3,250 an acre; and 80 acres E.½ of the NW.¼ at $3,250 an acre.

The interest of the North American Oil Consolidated in Section 22, Township 32, S., Range 23 E., was sold in 1915 for $350,000. Prior to the sale that property had produced 4,621,275.61 barrels of oil. More than half of petitioner's property in Section 22 (S.½ of SW.¼, NW.¼ of the SW.¼, the southern part of the N.½ of the SW.¼) was known to be south of the line of strike and therefore unproductive.

The interest of the North American Oil Consolidated in the lease of 160 acres in Section 26, Township 32 S., Range 23 E., was sold in 1916 for $175,000. Prior to January 1, 1913, that property had produced 1,878,998.69 barrels of oil. The interest sold was a lease of four-fifths working interest.

In 1910 the petitioner purchased about 40 acres, being the E.½ of the SE.¼ of Section 15, Town-

ship 32, Range 23, for $40,000. This purchase was primarily to obtain a site for sidetracks, warehouses, shops, etc.

The stock of the petitioner sold in 1910 at from $17.50 to $20 per share and during 1911 and 1912 for $20 per share; 5,466 shares being sold in 1910, 2,129 shares in 1911, and 470 shares in 1912.

The petitioner paid to Spellacy October 26, 1910, $2,500 and March 20, 1911, $40,000 for the purpose of clearing title to a part of Section 16.

On September 27, 1909, President Taft issued an order withdrawing from location practically all of the oil territory on the west side of San Joaquin Valley, included in which was Section 16, Township 32 S., Range 23 E. That [93] withdrawal order did not disturb vested rights in the land which had been acquired prior to September 27, 1909. In a very short time, operators and others in the district began to realize the Government meant business. To operators and dealers, it meant that all open land which they had been in the habit of appropriating by one means or another were going to be very difficult to obtain, that land upon which wells were drilling at the time of the order would be in a much better position; that Government land upon which wells were producing at the time of the order were fairly safe; but that after all, patented land was the only thing that was unassailable. As a result operators and oil men generally became alarmed at the condition of titles on unpatented lands and began to look covetously at patented land which they felt was worth while.

Section 16 was a school section belonging originally to the State of California, and sold by the state to some person.

The oil reserves in the land owned or leased by the petitioner in Section 16 were, 5,476,805 barrels on February 10, 1910, and 4,300,000 barrels at March 1, 1913.

The respondent, in computing invested capital, allowed an amount of $622,527.01, as representing the value of the property in Section 16, acquired for stock and bonds, and the $42,500 of expenditures made in perfecting title. However, in computing invested capital for the years at issue the respondent reduced capital stock and surplus by $1,638,611.21 instead of $877,472.99, the correct amount based upon the valuation allowed. This amount, $877,472.99 represents the difference between $1,500,000 at which Section 16 was entered in the books, and $622,527.01, the value allowed by the respondent.

On March 8, 1913, the petitioner entered into a contract with the General Petroleum Company for the sale of oil at 35¢ per barrel, but on March 1, 1913, the company was selling oil to the Standard Oil Company under contract at 50¢ a barrel.

[94] The corporation income and profits tax returns of the petitioner for the calendar year 1917 were filed on March 27, 1918. The income tax return showed an income tax liability of $9,886.07. The excess profits tax return showed excess profits tax liability for 1917 of $897.90.

A "waiver" dated January 19, 1923, consenting to

> Determination, assessment and collection of the amount of income, excess profits or war profits taxes due under any return made by or on behalf of the said company for the year 1917 * * * irrespective of any period of limitations

was filed on January 26, 1923.

A "waiver" dated January 2, 1924, consenting to

> Determination, assessment and collection of the amount of income, excess profits, or war profits taxes due under any return made by or on behalf of the North American Oil Consolidated for the year 1917 * * * irrespective of any period of limitations was filed on January 10, 1924.

A "waiver" dated January 12, 1924, consenting to

> Determination, assessment, and collection of the amount of income, excess profits, or war profits taxes due under any return made by or on behalf of said corporation for the years 1917 and 1918 * * * irrespective of any period of limitations was filed on January 17, 1924.

A "waiver" dated December 10, 1924, consenting to the

> Determination, assessment, and collection of the amount of income, excess-profits, or war-profits taxes due under any returns made by or on behalf of the said taxpayer for the year 1917 * * * for a period of one year after the expiration of the statutory period of limita-

tions within which assessments of taxes might be made for the year or years mentioned or the statutory period of limitations as extended by Section 277(b) of the Revenue Act of 1924, or by *an* waivers already on file with the Bureau. was filed on December 22, 1924.

The last "waiver" dated November 17, 1925, reads as follows:

[95] Treasury Department
Internal Revenue Service
Form 872A

INCOME AND PROFITS TAX WAIVER FOR TAXABLE YEARS ENDED PRIOR TO JANUARY 1, 1922.

November 17, 1925.

In pursuance of the provisions of existing Internal Revenue Laws The North American Oil Consolidated, a taxpayer of San Francisco, California, and the Commissioner of Internal Revenue hereby waive the time prescribed by law for making any assessment of the amount of income, excess-profits, or war-profits taxes due under any returns by or on behalf of said taxpayer for the year (or years) 1917 under existing revenue acts, or under prior revenue acts.

This waiver of the time for making any assessment as aforesaid shall remain in effect until December 31, 1926, and shall then expire except that if a notice of a deficiency in tax is sent to said taxpayer by registered mail before said date and (1) no appeal is filed therefrom with the United States

Board of Tax Appeals then said date shall be extended sixty days, or (2) if an appeal is filed with said Board then said date shall be extended by the number of days between the date of mailing of said notice of deficiency and the date of final decision by said Board.

(Seal) NORTH AMERICAN OIL CONSOLIDATED,

Taxpayer.

(Signed) By T. C. KIERULFF, President.
(Signed) FRANK EVANS, Secretary.
(Signed) D. H. BLAIR, Commissioner.

The sixty day letter was mailed to the petitioner on September 28, 1925.

During the year 1917 the petitioner paid $8,000 to the Oil Industry Association.

During the years 1917 and 1918 certain of the petitioner's oil derricks were damaged by fire. In repairing and rebuilding these oil derricks the petitioner made expenditures as follows:

| | |
|---|---|
| 1917 | $5,271.50 |
| 1918 | 7,095.41 |

The respondent allowed as a fire loss in 1917 the amount of $1,646.19, and as a fire loss in 1918 the amount of $3,500. He reduced invested capital for 1918 in the amount of $1,646.19 and for 1919 in the amount of $5,146.19 on account of fire losses.

[96] An oil derrick is a structure erected for the purpose of suspending tools for drilling, the tools consisting of the necessary equipment in the drilling of a well. After the well is drilled it is

necessary to maintain the derrick for the purpose of re-drilling or for pulling the tubing, making the necessary repairs to the well, baling, etc.

The petitioner acquired Section 2, Township 32, Range 23 East, M. D. B. & M., Kern County, California, by purchase on July 15, 1913. Some time prior to November 30, 1915, suit was instituted by the United States Government to oust the North American Oil Consolidated from possession of the premises and on February 3, 1916, the following order was entered in the District Court of the United States for the Southern District of California, Northern Division, Ninth Circuit, in Equity No. A–48:

UNITED STATES OF AMERICA,

Plaintiff,

vs.

NORTH AMERICAN OIL CONSOLIDATED, PIONEER MIDWAY OIL COMPANY, UNION OIL COMPANY OF CALIFORNIA, PRODUCER'S TRANSPORTATION COMPANY, WALTER P. FRICK, JOHN F. CARLSTON, CLARENCE J. BERRY, DENNIS SEARLES, WALTER H. LEIMERT and WICKHAM HAVENS,

Defendants.

ORDER APPOINTING RECEIVER.

This suit coming on to be heard on motion of the complainant for the appointment of a receiver

and for an injunction, and having been heard on the 30th day of November, 1915,—

IT IS NOW CONSIDERED, ORDERED AND ADJUDGED that Howard M. Payne be, and he hereby is, appointed receiver of all the property described in the Bill of Complaint herein claimed by the defendants, to wit:

> [97] All of Section Two (2), Township Thirty Two (32), South, Range Twenty-three (23) East, Mount Diablo Base and Meridian, and situated in Kern County, State of California.

and of the oil, gas and all other property of every kind now situated on the said land, or already extracted therefrom, and still in the possession of defendants; and the defendants, and each of them, their agents, attorneys and employees, are enjoined from removing said oil, gas, or other property or any part thereof, from said land, or in any manner interfering with the order of this Court, and are enjoined from further producing oil from said land, except by permission and under the direction of the said receiver.

Said receiver is directed to receive, and the said defendants are directed to surrender to said receiver all moneys in their hands or in the hands of any person or corporation for them, which are the proceeds of the sale of oil or gas produced from said land hereinbefore described, and such persons holding such funds are directed to pay same to said receiver; and the said receiver is directed to collect

any notes, accounts, or other evidence of debt due or payable on account of oil and gas produced from said land and sold by or for said defendants, or any of them.

The said receiver is given power and directed to operate any oil or gas well or wells on said property, or to permit them to be operated by the respective defendants now in possession of or operating same, or who have heretofore operated on said lands; or to close said wells, if he deems it necessary or advisable to do so in order to conserve the oil and gas in said lands and prevent said property from being damaged or the oil and gas from being wasted.

The said receiver is directed to ascertain the quantity of oil and gas heretofore extracted by said respective defendants, and what disposition has been made thereof, and keep an account thereof, and to keep an accurate account of all oil and gas hereafter produced from said lands, and to sell said oil and gas for the best price obtainable.

For the purpose of making an investigation and determining the condition of wells drilled on said lands, and particularly for the purpose of determining whether water is infiltering the oil sands or reservoirs on said lands, and for the further purpose of ascertaining the amount of oil and gas heretofore produced, the price at which the same has been sold, and the value thereof, the receiver is directed and empowered to examine the logs of the wells and the books of account kept by the defendants or any of them in the development and operation of said lands.

For the purpose of preventing damage to said lands by the infiltration of water into the oil lands and otherwise, and for the purpose of protecting and operating the said property and carrying out the provisions of this order, the said receiver is authorized to employ such assistants and incur such expense, to be paid out of the moneys coming into his hands as receiver, as he shall deem necessary, subject to the approval of this Court.

[98] A bond in the sum of Ten Thousand (10,000) Dollars, to be approved by this Court, shall be given by the receiver within fifteen days from the filing of this order; provided the solicitor for the complainant or for the defendants, or either of them, may at any time upon one day's notice to counsel for the opposite parties, apply to the court for an increase in the amount of said bond.

The moneys coming into the hands of the said receiver shall, unless otherwise directed by the Court, be deposited in a bank or banks in special interest bearing accounts in the joint name of the receiver and the clerk of this court, and subject to the joint check and control of such persons, except so much of said funds as may be necessary to pay the monthly current expenses of the receiver in executing the orders of this court, and such sums as may be necessary for such purposes shall be deposited in a bank or banks to the credit of such receiver, as receiver for the respective defendants, and shall be subject to the receiver's check.

The amount of compensation to be paid to the receiver in this suit is to be determined hereafter.

This 2 day of February, 1916.

M. T. DOOLING,
United States District Judge.

On June 5, 1917, the following decree was entered in this case:

FINAL DECREE.

This cause came on for hearing at a former day of this court and was argued by counsel and now, upon consideration thereof, it appearing to the Court that plaintiff is not entitled to the relief demanded in the complaint, or any part thereof, and there is no equity in the bill—

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the suit be and the same is hereby dismissed, that the injunction heretofore issued is dissolved, and the order appointing a receiver vacated;

PROVIDED, HOWEVER, that the Court will retain jurisdiction to settle and adjust the accounts of the receiver, who is hereby ordered and directed to make and file his final account within thirty days from the filing of this decree.

R. S. BEAN,
Judge.

Dated this 5th day of June, 1917. Decree entered and recorded June 7th, 1917.

WM. M. VAN DYKE,
Clerk.

(Res. Ex. III.)

[99] The cause was appealed (United States vs. North American Oil Consolidated, 242 Fed. 723, 264

Fed. 336) and it was finally disposed of by the Supreme Court of the United States in its mandate dated March 21, 1922, which provided as follows:

United States of America,—ss.

The President of the United States of America: To the Honorable the Judges of the United States Circuit Court of Appeals for the Ninth Circuit, GREETING:

Whereas, lately in the United States Circuit Court of Appeals for the Ninth Circuit, in a cause between the United States of America, appellant, and North American Oil Consolidated, Pioneer Midway Oil Company, Union Oil Company, of California, Producers Transportation Company, Walter P. Frick, John F. Carlston, Clarence J. Berry, Dennis Searles, Walter H. Leimert, and Wickham Havens, appellees, No. 3340, wherein the decree of the said Circuit Court of Appeals, entered in said cause on the 5th day of April, A. D. 1920, was in favor of the said appellees, North American Oil Consolidated et al., and against the said appellant, as by the inspection of the transcript of the record of the said United States Circuit Court of Appeals which was brought into the Supreme Court of the United States by virtue of an appeal agreeably to the act of Congress, in such case made and provided, fully and at large appears.

And whereas, in the present term of October, in the year of our Lord one thousand nine hundred and twenty-one of the said Supreme Court this cause having been called to the attention of the

Court by Mr. Solicitor General Beck, of counsel for the appellant, and it appearing to the Court that a stipulation of counsel for the respective parties to dismiss this appeal has been filed,

THEREFORE, in pursuance of said stipulation, it is now here ordered, adjudged and decreed by this Court that this appeal be, and the same is hereby, dismissed.

March 21, 1922.

You, therefore, are hereby commanded that such proceedings be had in said cause, as according to right and justice, and the laws of the United States ought to be had, the said appeal notwithstanding.

WITNESS, the Honorable WILLIAM H. TAFT, Chief Justice of the United States, the twenty-third day of March, in the year of our Lord one thousand nine hundred and twenty-two.

WM. R. STANSBURY,
Clerk of the Supreme Court of the United States.

(Res. Ex. IV.)

[100] Pursuant to the authority contained in the order appointing him, the receiver permitted the property to remain in the physical possession of, and to be operated by, the petitioner. At all times during the receivership the income from the oil produced from Section 2 was entered on the books of the petitioner as its income. The income from said Section 2 was not included in the petitioner's original return for 1916 which was filed in March, 1917, but was included in its amended return for 1916 which was filed on March 27, 1918. By letter dated March 23, 1918, attached to the amended re-

turn the respondent was fully advised as to all the facts regarding the litigation and receivership. A revenue agent made an examination of the petitioner's books in 1920.

The net income impounded in the hands of the receiver from Section 2, during the period from February 2, 1916, to December 31, 1916, and released in June, 1917, by the final decree of the United States District Court vacating the order appointing the receiver, was $171,979.22, of which $10,126.04 was turned over to Wheeler and Bowie in accordance with the terms of a contract dated January 1, 1916, between petitioner and Wheeler and Bowie.

On January 1, 1916, the petitioner entered into the following contract with Charles S. Wheeler and John F. Bowie:

THIS AGREEMENT, made this 1st day of January, 1916, by and between NORTH AMERICAN OIL CONSOLIDATED (a corporation), hereinafter referred to as the "COMPANY," party of the first part, and CHARLES S. WHEELER and JOHN F. BOWIE (copartners), Attorneys-at-law, hereinafter referred to as the "Attorneys," parties of the second part,

WITNESSETH:

Said parties, in consideration of a cash retainer heretofore paid by the Company to the Attorneys and of the promises and agreements on the part of each of them to be performed as hereinafter specified, agree and covenant, respectively, as follows:

[101] The Attorneys shall furnish all legal services necessary or proper and take all legal steps and proceedings to bring to final judgment and conclusion, in so far as the interests of the Company are concerned, three (3) certain actions now pending in the District Court of the United States for the Southern District of California, Northern Division, entitled "UNITED STATES OF AMERICA, Plaintiffs, vs. NORTH AMERICAN OIL CONSOLIDATED, ET AL., Defendants, in Equity, Number A 48," and "UNITED STATES OF AMERICA, Plaintiff, vs. RECORD OIL COMPANY, NORTH AMERICAN OIL CONSOLIDATED, ET AL., Defendants in Equity, Number A 41," and "UNITED STATES OF AMERICA, Plaintiff, vs. CONSOLIDATED MUTUAL OIL COMPANY, NORTH AMERICAN OIL CONSOLIDATED, ET AL., Defendants, in Equity, Number A 42." Said Attorneys shall further render all legal services necessary or proper to prosecute and procure the issuance of patents from the United States in respect of applications for patent now pending in the United States Land Office, in behalf of certain applicants, who have agreed to convey to the Company, which applications cover all of Section two (2), in Township thirty-two (32) South; Range twenty-three (23) East, M. D. B. & M., in the county of Kern, State of California, containing approximately six hundred and fifty (650) acres of land.

The Company agrees to supply and to advance to the Attorneys all necessary and proper costs and disbursements in connection with said court pro-

ceedings and land office proceedings and in any appeals or reviews thereof, as well as all necessary and proper traveling and incidental expenses of the Attorneys in connection therewith.

The Company further agrees in the event of the successful termination of said court and land office proceedings in its favor, and not otherwise, that four (4%) per cent. of all the oil, gas, or other mineral produced from said Section two (2) or any part of said section, from and after the first day of January, 1916, shall be and become the property of the Attorneys and shall be marketed by the Company to the best advantage and the entire proceeds of the sale thereof paid over to the Attorneys.

Successful termination of said court and land office proceedings, as intended by the parties hereto, means the issuance of patents by the United States Government, either covering the whole of said Section two (2) in favor of the applicants therefor who have agreed to convey the same to the Company, or the issuance of such patents covering any portion of said section, in which latter event said rights of the Attorneys shall attach to any and each portion patented.

In the event that the Attorneys shall become entitled to said four (4%) per cent of oil, gas, or minerals, as hereinabove provided, the times, methods and manner of delivering the same or the proceeds of sale thereof by the Company to the Attorneys, and all incidental rights of the Attorneys in respect thereto, shall be the same as the rights of the parties of the first part, J. S. Carlston, W. H. Leimert,

Wickham Havens, W. P. Frick, and Clarence J. Berry, in an agreement with said North American Oil Consolidated, dated the 11th day of July, [102] 1913, and a further supplemental agreement between the same parties, dated the 22nd day of July, 1913, save and except in the following particulars as to which the terms and conditions in said agreements contained, are agreed to be modified between the Company and the Attorneys, as follows:

FIRST: The Attorneys shall not be entitled to any of said products or the proceeds thereof except in the event of the successful termination of said proceedings as hereinabove provided; but in the event of such successful termination, the Company shall account to the Attorneys for the proceeds of the sale of four (4%) per cent of such mineral products from the first day of January, 1916, to the date of such successful termination, after which date the rights of the Attorneys shall attach, as hereinabove specified.

SECOND: The rights of the said Attorneys in respect of such four (4%) per cent shall be subject to the rights of the said Carlston and his associates so long as the said agreement and supplementary agreement shall remain in effect between said associates and the said Company, but said four (4%) per cent to which said Attorneys may become entitled shall be based upon the total production of minerals from the said property, without regard to the deductions in favor of said Carlston and his associates; and, furthermore, the rights of the Attorneys to such four (4%) per cent shall not terminate

upon the event specified in said agreements for the termination of the rights of said Carlston and his associates, but on the contrary shall continue in accordance with all the terms and provisions, *mutatis mutandis,* of the said agreement and supplemental agreement relative to the times, methods and manner of making payments or deliveries and rights incidental thereto, such as inspection, checking of production and securing continuity of production, storage of oil and conservation and protection of the premises, so long as there shall be any production of oil, gas, or other minerals from said premises, and the rights of the Attorneys to such four (4%) per cent upon attaching shall thereafter run with the land and bind the said Company and its successors and assigns.

IN WITNESS WHEREOF, the said party of the first part has caused its corporate name to be subscribed and its seal to be hereto affixed by its officers thereunto duly authorized, and the parties of the second part have hereunto set their hands on the day and year first above written.

NORTH AMERICAN OIL CONSOLIDATED.
By (Signed) LOUIS TITUS,
Its President.
By (Signed) C. F. NANCE,
Its Secretary.
(Signed) CHARLES S. WHEELER and
(Signed) JOHN F. BOWIE.

[103] The following amounts represent four per cent of that part of the gross production from

Section 2, Township 32 S., Range 23 E., which was sold in 1917, 1918 and 1919, respectively:

| | |
|---|---|
| 1917 | $20,441.18 |
| 1918 | 21,730.60 |
| 1919 | 27,136.91 |

These amounts were turned over to Wheeler and Bowie in the respective years in which received by the petitioner and deductions therefor were claimed in its income tax returns for the respective years.

For the year 1917 petitioner also deducted on its return the sum of $15,354.36, which represented four per cent of the sales price of the oil produced and sold in 1916, but not paid to Bowie and Wheeler until 1917.

The Commissioner disallowed as deductions the amounts claimed in 1917 and allowed as deductions the amounts claimed for the years 1918 and 1919.

The litigation over Section 2, Township 32 S., Range 23 E., was successfully terminated by the attorneys on March 23, 1922. On April 12, 1922, the United States patent to Section 2 was issued to certain applicants who had agreed to convey to petitioner.

During the year 1917 the petitioner expended $5,765.94 for pumping engines, sucker rods, small receiving oil tanks, well casing and tubing. This expenditure was disallowed as a deduction for business expenses in 1917 by the respondent. In accordance with the admission of the respondent at the hearing, under the circumstances in this case, the expenditures of $5,765.94 constituted an allowable deduction.

During the year 1918 $17,598 and during the year 1919 $5,049.28 were expended for gasoline engines used in operating the pumps at the various oil-wells. These amounts were added to capital and disallowed as expense deductions by the respondent.

[104] The respondent reduced invested capital on account of depletion sustained during prior years by the following amounts:

| | |
|---|---|
| 1917 | $602,820.96 |
| 1918 | 707,819.73 |
| 1919 | 819,751.89 |

He reduced invested capital for 1918 by an amount of $65,274.35 and for 1919 by an amount of $33,217.57, representing additional taxes for the previous year, prorated over the taxable year.

In computing invested capital and depletion allowances for the years 1917, 1918, and 1919, the respondent added the amount of $287,687.03 to the capital sum remaining in 1916, as shown by a valuation report dated July 30, 1925, which was stipulated in evidence solely for the purpose of showing respondent's computation of invested capital and depletion allowances. The sum so added was added as representing the capitalized cost of wells developed on Section 16, Township 32 S., Range 23 E., during 1916. The amount involved was actually expended by the petitioner in drilling wells during the years 1910 and 1911 as follows: $51,727.64 in 1910 and $235,959.39 in 1911, and these sums should have been added to capital account during the years 1910 and 1911.

## OPINION.

ARUNDELL.—By amendment to its petition in Docket No. 8714 the petitioner claims that collection of any taxes for the year 1917 is barred by the statute of limitations. By the terms of Commissioner's mimeograph 3085, promulgated April 11, 1923, the "waiver" of January 19, 1923, expired on April 1, 1924. Before the expiration date of the first "waiver" a second one was executed on January 2, 1924, and filed January 10, of the same year. A third was executed on January 12, 1924, and filed on January 17, 1924, which was identical with the January 2d "waiver" except that the year 1918 was included. These latter "waivers" were not affected by mimeograph 3085, Cunningham Sheep and Land [105] Company, 7 B. T. A. 652, and the period for assessment and collection of taxes for 1917 had not expired when the further "waiver" was filed on December 22, 1924, extending for an additional year the period for assessment and collection.

The last "waiver," dated November 17, 1925, for the year 1917 was filed prior to the date the last mentioned "waiver" would expire, and provided that assessment could be made up to December 31, 1926. No provision for collection was included in this "waiver," but this becomes unimportant in view of the provisions of Section 278(d) of the Revenue Act of 1924. Sunshine Cloak and Suit Company, 10 B. T. A. ——. We are of the opinion that the statute has not expired either on the assessment or collection of taxes for the year 1917.

Several witnesses testified that they knew Section 16 in general, or had been over it; that they were familiar with various sales of land in this oil-field and that the petitioner's land in Section 16 was worth about $3,000 an acre on February 10, 1910, and in excess of that amount on March 1, 1913. Some of the witnesses predicated this value upon the favorable location of Section 16 in relation to a theoretical "gusher zone" which was supposed to pass through the northeast quarter.

The sales which were cited as a basis for comparison were very briefly presented, without any details that might make direct comparison possible. The sale of 8 acres for $25,000 in Section 25, Township 32, Range 23, by Barlow was too remote in point of time to have much weight in a valuation as of 1910. The same may be said of the sale by Laymance of 20 acres in Section 19, Township 30, Range 22, in January, 1909, and in addition this property being some 18 miles away, was exceedingly remote for direct comparison.

[106] The purchase by Laymance in Section 36, Township 12, Range 34, at $500 an acre in April, 1909, and later sale of a part thereof at $3,000 an acre is of land over five miles distant from Section 16. The date of the sale is not given, but the record shows that a gusher came in on this section in November, 1909, known as the "Wellman"; also a gusher came in on the adjoining Section 35 in August, 1909.

The sale in Section 30, Township 31, Range 23, in June, 1910, for cash and bonds was just after

a well producing 6,000 to 7,000 barrels a day came in on the property.

The sale in Section 2, Township 11, Range 24, in September, 1910, was admitted to have been consummated largely on the showing of the Lake View gusher which was only about a mile distant.

The sale by Tryon in Section 36, Township 12, Range 24, in November or December, of 1909, for $3,000 an acre was after a gusher came in on Section 35, and probably after the Wellman gusher came in on Section 36.

The sales in Section 32, Township 32, Range 24, in the summer of 1910, were apparently after the Lake View gusher came in less than 2 miles away, and after the gusher came in on Section 30, Township 32, Range 24, the property adjoining to the northwest.

From these sales it is apparent that values depend largely upon local or near-by development. No sale was cited at rates of $3,000 an acre or over in 1909 or 1910 unless the property was near or associated with a gusher. The great divergence of values from $200 an acre to $6,000 an acre indicates the great difficulty of direct comparison.

The land in Section 16 was acquired in part by the predecessors of the petitioner and in part by the petitioner. Some of the prices were agreed upon in the middle of 1909, and therefore might be considered remote in point of [107] time from February 10, 1910. However, there were certain transactions in 1910 that have some bearing on the value of this section. On February 4, 1910, Louis

Titus purchased the N.½ of the NE.¼ of the SE.¼ of Section 16, twenty acres, for $30,000, or $1500 an acre. This was only 6 days prior to the date of acquisition by the petitioner and was apparently an arm's length transaction consummated on that date, since prior to that time Louis Titus had no options or leases or agreements on this land. On February 3, 1910, Titus acquired a lease on the E.½ of the NE.¼, the NW.¼ of the NE.¼, and the North 15 acres of the N.½ of the SW.¼ of the NE.¼, no bonus being paid therefor, but providing for a one-fifth royalty. In so far as the E.½ of the NE.¼ is concerned, this transaction was at arm's length and Titus had previously no option agreements or leases on this portion, which were effective at the time this lease was made. The land covered by this lease was purchased by the petitioner in August, 1910, when $200,000 par value of bonds and $200,000 par face value of stock, together with $2,244.50 in cash was paid over to the Lockwood Company. The petitioner has introduced evidence which convinces us that on Augnst 10, 1910, the bonds had a market value of eighty per cent of the face value, and the stock twenty per cent of par. Assuming that all of the consideration was paid for the 135 acres under lease, the rate would be approximately $1500 per acre. This land included practically all of the area in Section 16, which had been designated by the experts as lying within the "gusher zone." This sale was made after the Regal No. 1 gusher came in on Section 14, a little over one mile to the east, and after the Lake

View gusher came in on Section 25, Township 42, Range 24, and the Standard gusher on Section 30, Township 32, Range 24.

The S.½ of the SW.¼ was also purchased by the Hartford Oil Company on or before February 10, 1910, and the petitioner does not contend that it was [108] purchased before February 10. This land was acquired for $78,480, or approximately $980 an acre.

The transactions within Section 16 that are evidence of value on February 10, 1910, are:

30 acres, N.½ of NE.¼ of SE.¼, purchased at $1,500 an acre.

135 acres, NE. ¼, Fee subject to lease, purchased at $1,500 an acre.

80 acres, SW.¼, Fee subject to lease, purchased at $980 an acre.

The purchase of the 135 acres in August, 1910, is considered a maximum value applicable to the 135 acres as of February 10, 1910, in view of the testimony as to general increase in values in this district.

These transactions within Section 16 itself covering over half the area, are certainly of material value in ascertaining the actual cash value of the entire holdings of the petitioner in Section 16, and the weight that should be given to the theory of the "gusher zone" passing over the northeast quarter.

There is evidence in the record which would raise some doubt as to the possibility of finding a "gusher" in the NE.¼ of Section 16. The exhibits introduced in evidence disclose the depth at which

various gushers penetrated the oil sands and we have set forth in our findings of fact this information as it applies to certain wells.

The gushers located to the east and southeast of Section 16 penetrated the oil sands at from 1100 to 1500 feet below sea level. The exhibits show that the deepest sands that could be drilled in Section 16 were only about 700 feet below sea level.

The "gushers" to the northwest encountered the sands at points where the oil sands were indicated at sea level or above sea level. It is also shown by the exhibits submitted that the "gushers" to the northwest are not located on the Spellacy Anticline, and therefore the conditions in that section are not indicative of what might be expected on the Spellacy Anticline.

[109] The developments surrounding Section 16 at February 10, and March 1, 1913, did not reduce this doubt but rather increased it since no "gushers" were found within a mile of Section 16, although numerous wells were drilled to the northwest and southeast and many wells were drilled to the east and north. The record shows that wells were drilled in Section 9, one-half mile to the north, in Section 15, very near the eastern line of Section 16, in Section 14, southwest corner. None of these wells, although located in the so-called "gusher-zone," are reported as being "gushers" or even commercial wells.

By March 1, 1913, some 100 wells had been drilled in the " gusher zone" for Section 6, Township 32, Range 23, to Section 30, Township 32, Range 24,

and only one real "gusher," the Regal No. 1, was developed. This well penetrated the sands at a point where the sands are indicated at a depth of 1300 feet below sea level.

It was subsequent to the date when this well came in that the petitioner was able to purchase the fee to 135 acres in the NE.¼ of Section 16 at a price of some $1,500 an acre, indicating that the previous owners of the property placed little reliance on the possibility of a "gusher zone" being found in that area.

The wells put down by the petitioner in the NE.¼ in 1911 also tended to disprove the "gusher zone" theory. Well No. 71 was drilled in the extreme northeast corner and produced about 50 barrels a day. Well No. 67 was in the northwest corner and produced 100 barrels a day. Both of these wells were in a theoretical "gusher zone."

After a review of all the testimony we are of the opinion that the cost of Section 16 to the petitioner was as follows:

[110]

| | |
|---|---|
| Leasehold on 135 acres in NE.¼, acquired by the predecessor 7 days prior to February 10, 1910 | No bonus value |
| S.½ of SW.¼, acquired on or before February 10, 1910, by predecessor for $78,480.00 | $ 78,480.00 |
| Balance of area comprising about 265 acres, valued at $1,500 an acre | 397,500.00 |
| | $475,980.00 |
| Subsequently paid to perfect title | $ 42,000.00 |

Fee title to 135 acres acquired in August, 1910, for bonds and stock, and cash.. 202,244.50

Total cost ..... $720,224.50

Between February, 1910, and March 1, 1913, about 26 wells were drilled in the S.½ of Section 16. One well, No. 34, produced from 300 to 400 barrels a day and was considered very valuable. The cost of this development was $51,727.64 in 1910 and $235,959.39 in 1911, a total of $287,687.03. The production from Section 16 prior to March 1, 1913, was 90,414 barrels in 1910, 425,000 barrels in 1911, 580,775 barrels in 1912, and 84,513 barrels for two months in 1913, or a rate of 507,000 barrels a year.

The estimate of oil content at March 1, 1913, made by the petitioner's geologist was 4,300,000 barrels. The market price of oil at March 1, 1913, was not over 35 cents a barrel. In order to realize this production it would appear that some 60 or 70 additional wells would have to be driven. The average cost of wells in the S.½ of Section 16 was $8,000 to $9,000 a well, and since wells in the N.½ of the SE.¼ and in the NE.¼ would have to be deeper, the average cost would be greater. Then, in order to develop this property, $700,000 to $800,000 would have to be spent in drilling wells.

With all of these conditions in view and after considering the opinions of the various witnesses, we are of the opinion that the fair market value [111] of the petitioner's oil land in Section 16 was $700,000 exclusive of the value of development already completed. Accordingly the depletion rate

would be based on this value and 4,300,000 barrels of oil.

The petitioner is also entitled to a deduction based on the development expended in 1910 and 1911. These expenditures were capital expenditures subject to exhaustion based on the reserve in February, 1910, of 5,476,805 barrels.

During 1917 the petitioner paid to the Oil Industry Association $8,000. No evidence was presented on this issue and consequently the action of the respondent is approved.

During 1917 and 1918 it *appreas* that certain damage was done to oil derricks by fire and certain sums were expended in restoring the derricks. The destruction of a derrick, or a part of a derrick, by fire resulted in a loss, and a loss of this character represents an allowable deduction under section 214 (a) (4) of the Revenue Act of 1918. The amounts spent in restoring the property destroyed are capital expenditures. Accordingly, the action of the Commissioner in respect to this issue is approved. Nor do we find error in the action of the respondent in reducing invested capital for 1918 and 1919 in amounts equal to the amounts allowed as deductions for fire losses.

No testimony was introduced relative to the expenditures for gasoline engines in 1918 and 1919. Expenditures of this nature are normally capital expenditures. The action of the Commissioner in disallowing the deductions is approved.

During the years here involved the petitioner was in complete possession of Section 2, except that

from February 2, 1916, to June 5, 1917, it was operating under the supervision and control of a receiver. It accrued in [112] each year on its books the income applicable to the oil produced and sold. During 1917, however, it did receive the amounts which had been held by the receiver representing income from February 2, 1916, to June 5, 1917.

The respondent affirmatively alleges that the amount impounded in the hands of the receiver in 1916 and released to petitioner in 1917 was income to the petitioner in the latter year. The respondent's principal argument in support of his claim herein is that petitioner was on the cash receipts and disbursements basis in the years 1916 to 1919, inclusive, and, as the amount here involved was not actually received by the petitioner until 1917 it must be taxable income in that year. We think it immaterial whether petitioner's accounts were kept on the receipts and disbursements basis or some other basis as permitted by section 13(d) of the Revenue Act of 1916. The fact is that the income was actually produced in 1916. The sole reason that it did not reach the petitioner in that year was because of the suit by the United States. By reason of that suit a receiver was appointed, who actually received the income, and who should have reported it for taxation. Section 13(c) of the Revenue Act of 1916; United States vs. Chicago & E. I. Ry. Co., 298 Fed. 379; Forstmann vs. Ferguson, 17 Fed. (2) 659, affirmed, —— Fed. (2) ——. If the receiver did not report it, that is no sufficient

reason for taxing the petitioner on it in a later year. Accordingly, the amount of $171,979.22 received by petitioner in 1917 is not an item of income in that year. This amount is the amount stipulated as being the net income impounded in the hands of the receiver during the period February 2, 1916, to December 31, 1916. The amount which the respondent alleges should be included in 1917 income is $253,150.96. What the difference consists of we do not know. The burden being on the respondent to establish his affirmative allegation in regard [113] to this amount, and he having failed to do so, we must hold that no part of it may be included in income for 1917.

The parties have stipulated that the amounts paid to Wheeler and Bowie in 1917, 1918 and 1919 represented four per cent of gross production specified in the contract, also that $35,795.54 deducted in 1917 represented accruals for 1916 and 1917. Since the four per cent in 1917 amounted to $20,441.18, the accrual for 1916 must have been the difference or $15,354.36.

The agreement with Messrs. Wheeler and Bowie provided that the petitioner would pay to them four per cent of all the oil, gas, or other mineral produced from Section 2, in the event of the successful termination of certain court and land office proceedings and not otherwise, that "successful termination of said court and land office proceedings * * * means the issuance of patents by the United States Government, either covering the whole of Section 2 in favor of the applicants there-

fore * * * or the issuance of such patents covering any portion of said section, in which latter event said rights of the attorneys shall attach to any and each portion patented"; that "the attorneys shall not be entitled to any of said products or the proceeds thereof except in the event of the successful termination of said proceedings * * * but in the event of such successful termination the Company shall account to the Attorneys for the proceeds of the sale of four per cent of such mineral products from the first day of January, 1916, to the date of such successful termination after which date the rights of the Attorneys shall attach"; that "the rights of the Attorneys to such four (4%) per cent upon attaching shall thereafter run with the land and bind the said Company and its successors and assigns."

The petitioner contends that the agreement with the attorneys conveyed to them an interest in the real estate, and consequently the proceeds derived [114] from the sale of four per cent of the oil were not income to the petitioner since by agreement the petitioner owned only a ninety-six per cent interest in the oil property.

In support of this contention the petitioner cites the case of Graciosa Oil Company vs. Santa Barbara, 155 Cal. 140, 99 Pac. 483, which involved taxes assessed against the lessee of oil property. In this case the Court said:

> But the contract in question vests no present title in a stratum in place. It leaves the title to the oil in the land owners until it is brought

to the surface. The right vested in the plaintiff is an estate for years, so far as necessary for the purpose of taking oil therefrom, and it carries with it the right to extract the oil and remove it from the premises. This right constitutes, for the term prescribed, a servitude on the land and a chattel real at common law.

We fail to see that the rights of the attorneys in this case are at all similar to the rights of the lessee in the Graciosa case. The attorneys had the right to receive four per cent of the oil produced. They had no right to extract oil or to enter upon the land for that purpose, a point on which the decision in the Graciosa case was largely based. If oil was not produced from Section 2, the attorneys would have no claims which they could enforce. By no exercise of the imagination can we read into the agreement any assignment of a portion of the fee title to land, nor any title to an undivided interest in the oil stratum. The attorneys' rights begin only after oil has been produced, and then only to the extent of receiving four per cent of the oil produced or the proceeds of a sale thereof. We are, therefore, of the opinion that the attorneys did not acquire an interest in the real estate, and that all of the income derived from the sale of oil from Section 2 was income of the petitioner.

[115] We have held that the expenses of defending title are capital expenditures. Consolidated Mutual Oil Co., 2 B. T. A. 1067; West End Consolidated Mining Co., 3 B. T. A. 128; Bugher et al., Executors, 9 B. T. A. 1155. Therefore, the amounts

paid the attorneys in 1917, 1918 and 1919 are not deductible as expense, but are capital expenditures.

The amounts paid the attorneys being capital expenditures, it follows that depletion is allowable in respect of such amounts. The question then arises as to how such allowances shall be computed. Ordinarily, depletion is allowable in respect of capital costs by spreading the cost over the remaining life of the oil reserves. But that method is inapplicable here for the reason that as the oil reserves were depleted the capital cost would be annually increased, which would necessitate an annual increase in the depletion rate and result in unreasonable depletion deductions. Such a method might do very well and might be the only one that could be used where the capital cost was applicable only to future production, but here the amount paid in any year is a part of the cost of both past and current production as well as that in the future. The solution that seems to us will produce a proper result is to allow as depletion in each year an amount equal to the four per cent paid to the attorneys. By this method, when eventually production ceases, the petitioner will have returned to it through the depletion allowances exactly the amount of its capital expenditure and the depletion deduction each year will be reasonable.

In computing invested capital for the years in question surplus should be reduced by the depletion sustained due to the extraction of oil from the property. Such depletion should be based upon the cost of the oil properties and subsequent capital additions, the oil reserves applicable thereto and the oil

extracted to the year in question. This is in accord with the several [116] cases involving depreciation sustained, previously passed upon by the Board, and is in accordance with the decision in W. S. Bogle and Co., Inc., 5 B. T. A. 541, and Entress Brick Co., 9 B. T. A. 588. The depletion sustained should be recomputed in the light of the finding in this case.

In accordance with the stipulation respecting the capital expenditures of $51,727.64 in 1910 and $235,959.39 in 1911, these amounts should be taken into capital accounts for the years in which expended, and the undepleted balances added to capital sum remaining in 1916 for the purpose of computing invested capital and depletion allowances for 1917, 1918 and 1919.

The reduction of invested capital for the years 1917, 1918 and 1919 on account of depletion sustained in prior years was alleged in the petitions as an error on the part of the respondent. This was not urged at the hearing, being only briefly mentioned by counsel for petitioner in his opening statement, and is not mentioned at all in petitioner's brief. We affirm the respondent's computation in principle, but adjustments will necessarily be made in the amounts upon the basis of value of petitioner's lands for depletion purposes as found by this decision.

The respondent's reduction of invested capital on account of prior years' taxes is likewise affirmed in principle, Section 1207, Revenue Act of 1926; Russel Wheel & Foundry Co., 3 B. T. A. 1168, but

the amounts by which invested capital is reduced will need revision to conform to changes in taxes wrought by this decision. This is a matter to be settled under Rule 50.

Judgment will be entered under Rule 50.

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Now, November 6, 1930, the foregoing findings of fact and opinion certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[117] United States Board of Tax Appeals, Washington.

DOCKET Nos. 8714–16,107.

NORTH AMERICAN OIL CONSOLIDATED,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

## DECISION.

Pursuant to opinion and findings of fact promulgated May 24, 1928, the respondent herein, to wit, on August 20, 1929, having filed a proposed re-determination for the years 1917, 1918 and 1919, and the petitioners on August 23, 1929, having filed notice of acquiescence to the said proposed re-determination, it is

ORDERED AND DECIDED that there are deficiencies for the years 1917, 1918 and 1919 in the

amounts of $35,806.30, $25,978.28 and $21,697.65, respectively.

(Signed) C. ROGERS ARUNDELL,
Member, U. S. Board of Tax Appeals.

Entered Aug. 29, 1929.

vlh.

A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

Now, November 6, 1930, the foregoing decision certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[118] Filed Feb. 13, 1930. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET Nos. 8714–16,107.

ROBERT H. LUCAS, Commissioner of Internal Revenue,

Petitioner,

vs.

NORTH AMERICAN OIL CONSOLIDATED,

Respondent.

PETITION FOR REVIEW IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT AND ASSIGNMENTS OF ERROR.

Comes now Robert H. Lucas, Commissioner of

Internal Revenue, by his attorneys, C. A. Youngquist, Assistant Attorney General and C. M. Charest, General Counsel, Bureau of Internal Revenue, and respectfully shows:

I.

That he is the duly appointed, qualified and acting Commissioner of Internal Revenue appointed and holding his office by virtue of the laws of the United States; that the North American Oil Consolidated (hereinafter called the taxpayer) is a corporation organized and existing under the laws of the State of California whose principal office is located in the city of San Francisco, California, and whose Federal income tax return for the calendar year 1917 was filed in the office of the Collector of Internal Revenue for the First District of California, which is within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit.

[119] II.

The nature of the controversy is as follows:

The taxpayer, since its organization in 1910, and during the years 1916 and 1917, was engaged in the business of producing oil. In the course of its business it derived income from oil-wells on many parcels of land. One of these parcels was acquired by purchase on July 15, 1913, and described as Section 2, Township 32 south, Range 23 east, Mt. Diablo Base and Meridian situated in Kern County, California. Thereafter suit was instituted by the United States Government to oust the taxpayer from the possession of said Section 2. On February 2, 1916, an order was entered in the District Court

of the Southern District of California, Northern Division, appointing a receiver to receive all income derived from this property and to operate or supervise the operation of the oil-wells on this property. The order appointing the receiver was vacated by final decree of the District Court on June 5, 1917. During the period February 2, 1916, to December 31, 1916, the receiver collected and impounded net income from oil-wells on said Section 2 amounting to $171,979.22. This amount was turned over to and received by the taxpayer in June, 1917. The income from said Section 2 was not included in the taxpayer's original return for 1916 which was filed in March, 1917, but was included in an amended return for 1916 which was filed on March 27, 1918. The taxpayer was on the cash receipts and disbursement basis during the years in question. It is the position of the petitioner that the amount impounded in the hands of the receiver in 1916 and released to the taxpayer in 1917, was income to the taxpayer in the latter [120] year, and that as the taxpayer was on the cash receipts and disbursement basis in the years 1916 and 1917, and as the amount involved was not actually received by the petitioner until 1917, it must be taxable income for that year. The Commissioner determined a deficiency for the year 1917 in the amount of $109,239.61, which deficiency, however, did not include tax on the above amount received by the taxpayer in 1917, which had been impounded by the receiver in 1916. The Commissioner, in his amended answer in the proceedings before the Board, affirmatively alleged that he erred in not including as taxable in-

come in 1917 an amount of $253,150.96 received by the taxpayer in that year, which had been impounded by the receiver in 1916. The Board found that it was stipulated that the net income so received from this source was $171,979.22. After giving effect to other adjustments made by the Board and including said $171,979.22 as income for 1917, the deficiency in tax for 1917 amounts to $128,610.36.

That in the proceedings before the Board of Tax Appeals the years 1917 to 1919 were involved and the controversy related to numerous errors alleged on the part of the taxpayer and the Commissioner, some of which were decided by the Board in favor of the Commissioner and some in favor of the taxpayer; but the controversy in this petition for review relates solely to the year 1917 and in respect to the amount of net income impounded by the receiver in 1916 received by the taxpayer in 1917, and the sole question is whether or not said amount shall be included in taxpayer's income for the year 1917.

[121] III.

The taxpayer appealed from the said determination of the Commissioner to the United States Board of Tax Appeals; and the Board ordered and decided that there was a deficiency in tax for the year 1917 in the amount of $35,806.30.

The hearing before the Board of Tax Appeals was held on May 2 to May 6, 1927; the report of the Board, its findings of fact and opinion were promulgated May 24, 1928; and final order or redetermination adjudging that there was a deficiency as set forth above was entered August 29, 1929.

IV.

The said Commissioner being aggrieved by the conclusion of law made by the Board of Tax Appeals in said report, and also by said order of re-determination, desires to obtain a review of said report and order by the United States Circuit Court of Appeals for the Ninth Circuit; and as reason for such review he alleges that the Board in rendering its opinion and entering its final order of re-determination committed the following errors:

1. The Board erred in determining that there was a deficiency in the amount of the taxpayer's income and profits taxes for the year 1917 in the amount of only $35,806.30, and in failing to determine that there was a deficiency for said year in the amount of 128,610.36.

2. The Board erred in determining that the amount of $171,979.22, being the net income impounded in the hands of the receiver during the period February 2, 1916, to December 31, 1916, and received by the [122] taxpayer in 1917, is not an item of income for the year 1917.

3. The Board erred in holding that it was immaterial whether taxpayer's accounts were kept on the receipts and disbursement basis in respect to said amount of $171,979.22 received by the petitioner in 1917, which amount was impounded by the receiver in 1916.

4. The Board erred in determining that the receiver, appointed because of a suit by the United States, impounded net income in the amount of $171,979.22 in 1916, should have reported it for taxa-

tion, and not having reported it there is not sufficient reason for taxing the taxpayer in the later year.

5. The Board erred in determining as follows:

> "We think it immaterial whether petitioner's accounts were kept on the receipts and disbursements basis or some other basis as permitted by Section 13(d) of the Revenue Act of 1916. The fact is that the income was actually produced in 1916. The sole reason that it did not reach the petitioner in that year was because of the suit by the United States. By reason of that suit a receiver was appointed, who actually received the income, and who should have reported it for taxation. * * * If the receiver did not report it, that is no sufficient reason for taxing the petitioner on it in a later year. Accordingly, the amount of $171,979.22 received by petitioner in 1917 is not an item of income in that year."

WHEREFORE, the Commissioner petitions that said decision of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said court and be transmitted to the Clerk of said court for filing; [123] and that appropriate action be taken to the

end that the errors herein complained of may be reviewed and corrected by said court.

G. A. YOUNGQUIST.
G. A. YOUNGQUIST,
Assistant Attorney General.
C. M. CHAREST.
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

United States of America,
District of Columbia,—ss.

C. M. Charest, being first duly sworn, says that he is General Counsel for the Bureau of Internal Revenue, and as such is duly authorized to verify the above and foregoing petition for review to the United States Circuit Court of Appeals for the Ninth Circuit; that he has read said petition for review; that he is familiar with the statements therein contained; and that the same are true to the best of his knowledge, information and belief.

C. M. CHAREST.
C. M. CHAREST.

Subscribed and sworn to before me this 13th day of February, 1930.

[Seal] WILFORD H. PAYNE,
Notary Public.

My commission expires November 5, 1932.

[124] United States Board of Tax Appeals.

DOCKET Nos. 8714–16,107.

ROBERT H. LUCAS, Commissioner of Internal Revenue,

Petitioner,

vs.

NORTH AMERICAN OIL CONSOLIDATED,

Respondent.

To North American Oil Consolidated, 544 Market Street, San Francisco, California.

Sirs:

You are hereby notified that the Commissioner of Internal Revenue did on the 13th day of February, 1930, file with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and assignments of error as filed is hereto attached and served upon you.

C. M. CHAREST,
F.
Attorney for Petitioner,
General Counsel,
Bureau of Internal Revenue.

Dated at Washington this 13th day of February, 1930.

Personal service of the above and foregoing notice, together with the copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 18th day of February, 1930.

NORTH AMERICAN OIL CONSOLIDATED,
Respondent.
By FRANK EVANS,
Secretary.

Now, November 6, 1930, the foregoing petition for review, notice of filing and proof of service certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[125] United States Board of Tax Appeals.

DOCKET Nos. 8714–16,107.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

NORTH AMERICAN OIL CONSOLIDATED,
Respondent.

STATEMENT OF EVIDENCE.

The above-entitled cause came on for hearing before the Hon. C. Rogers Arundell, Member of the United States Board of Tax Appeals upon the 2d day of May, 1927, there being present the petitioner and respondent by their respective counsel.

Thereupon the following proceedings were had and testimony heard by said Member. All of the evidence introduced by both parties to the above-entitled cause which is materially necessary to a determination of the assignments of error set out by petitioner in its petition for review by this Court of the decision of the Board of Tax Appeals is herein set forth. Except as the same are at variance with, or controverted by, this statement of evidence, the findings of fact made by the Board of Tax Appeals are accepted as correct and to that extent adopted for the purposes of this appeal.

The stipulation of facts agreed to by the parties before the Board of Tax Appeals is as follows:

"PETITIONER'S STIPULATION OF FACTS."

"It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that subject to the right of [126] either party to introduce admissible evidence not inconsistent herewith, the following may be taken and considered as facts in the trial of the above-entitled cause:

(1) That the Petitioner was organized on February 10th, 1910, under the laws of the State of California.

(2) That attached hereto as 'Exhibit A' is a true and correct copy of the minutes of the meeting of the Board of Directors of the North American Oil Consolidated held on February 10, 1910, and that said copy may be considered in evidence in lieu of the original minute book of said corporation.

(3) That the properties referred to in said minutes ('Exhibit A') were duly acquired by Petitioner on February 10, 1910, and its stock and bonds were on said date duly issued in exchange therefor in accordance with the authorization contained in said minutes.

(4) That attached hereto as 'Exhibit B' is a true and correct copy of the minutes of the meeting of the Board of Directors of the North American Oil Consolidated held on August 25, 1910, and that said copy may be considered in evidence in lieu of the original minute book of said corporation.

(5) That the properties referred to in said minutes ('Exhibit B') were duly acquired by Petitioner on August 25, 1910, and its stock and bonds and cash were on said date duly issued in exchange therefor in accordance with the authorization contained in said minutes.

(6) That attached hereto as 'Exhibit C' is a true and correct copy of the minutes of the meeting of the Board of Directors of the [127] North American Oil Consolidated held on May 27, 1912, and that said copy may be considered in evidence in lieu of the original minute book of said corporation.

(7) That the authorized capital stock of Petitioner was reduced in accordance with the authorization contained in the minutes of said meeting of the Board of Directors held on May 27, 1912.

(8) That the Respondent admits that the adjustment to invested capital of 'excess valuation of property $1,638,611.21,' shown on page 3 of the sixty day letter for 1917 dated September 28, 1925, and

on pages 2 and 5 of the sixty day letter for 1918 and 1919 dated April 9, 1926, should be reduced by the amount of $761,078.22, leaving a balance of $877,472.99 which the Respondent now alleges to be 'excess valuation of property,' instead of the aforesaid figure of $1,638,611.21.

(9) That said amount of $877,472.99 represents the difference between $1,500,000.00, the value at which the Petitioner's 480 acres in Section 16 was shown on its balance sheet as of December 31, 1916 (without any deduction for depletion sustained), and $622,527.01 the value at which the Respondent has included said 480 acres in said Section 16 in the Petitioner's invested capital (except for an additional $50,000.00 allowed in the aforesaid sixty day letter as 'Paid in Surplus Account Stock Sales,' and likewise without any deduction for depletion sustained).

[128] (10) That the value of $622,527.01 used by the Respondent as the value of Section 16 for invested capital purposes was arrived at by the respondent as shown on pages 5 and 6 of Revenue Agent's Report dated September 18, 1920, copies of which are attached hereto as 'Exhibits D and E,' for the purpose only of showing the Respondent's computation.

(11) That the cost of said lands in said Section 16, T. 32, S. R. 23 E., M. D. B. & M., which were acquired by the North American Oil Consolidated on February 10, 1910, as shown by 'Exhibit A' attached hereto, to the Hartford Oil Company and

Louis Titus Pool, predecessors of the North American Oil Consolidated, was as follows:

Section 16.

| | |
|---|---|
| 1. Hartford Oil Company, fee SE.¼ of SE.¼ | $42,000.00 |
| 2. Hartford Oil Company, fee N.½ of SW.¼; W.½ of SE.¼; S.½ of NE.¼ of SE.¼; S.½ of SW.¼ of NE.¼; 5.5 acres of N.½ of SW.¼ of NE.¼ | 205,616.25 |
| 3. Hartford Oil Company, lease S.½ of SW.¼ | 10,000.00 |
| 4. Louis Titus Pool, fee S.½ of SW.¼ | 68,480.00 |
| 5. Louis Titus Pool, fee N.½ of NE.¼ of SE.¼ | 30,000.00 |
| Total | $356,096.25 |

(12) The petitioner made payments as follows for the purpose of clearing title to a part of Section 16:

| | |
|---|---|
| Spellacy, October 26, 1910 | $ 2,500.00 |
| Spellacy, March 20, 1911 | 40,000.00 |
| | $42,500.00 |

[129] (13) The value of the lands acquired for stock in 1910 was not segregated on the books of the company so as to show the respective values of land in Sections 16, 22 and 26, until Section 22 was sold in 1915, when the following segregation of values was made upon the books of the company:

| | Value |
|---|---|
| Section 16 property ..... | $1,500,000.00 |
| Section 22 property ..... | 900,000.00 |
| Section 26 property ..... | 385,755.08 |
| | $2,785,755.08 |

(14) That the Petitioner sold its interest in Section 22 in 1915 and its interest in Section 26 in 1916.

(15) That in computing the Petitioner's allowable deduction for depletion on said 480 acres in said Section 16, the Respondent has used a value of said lands in said Section 16 as of March 1, 1913, of $400,000.00 and an estimated oil content as of that date of 2,694,842 barrels.

(16) That the following is a true and correct statement of the production by months for the years 1910, 1911 and 1912 respectively of the North American Oil Consolidated from its property in Section 16, T. 32, S. R. 23 E., M. D. B. & M., Kern County, California:

Section 16.

| Month | 1910 | 1911 | 1912 |
|---|---|---|---|
| January | 3,979.88 | 6,301.83 | 57,441.80 |
| February | 6,203.80 | 5,035.98 | 47,871.28 |
| March | 5,053.50 | 26,464.20 | 47,003.88 |
| April | 9,003.30 | 34,292.94 | 49,136.51 |
| May | 12,864.03 | 44,219.63 | 49,344.37 |
| June | 8,837.67 | 42,234.54 | 49,267.63 |
| July | 7,527.68 | 41,504.31 | 49,600.40 |
| August | 6,426.13 | 41,309.70 | 48,743.02 |
| September | 7,748.44 | 41,466.42 | 49,619.18 |

| | | | |
|---|---|---|---|
| October | 8,924.63 | 45,819.81 | 44,088.26 |
| [130] | | | |
| Month | 1910 | 1911 | 1912 |
| November | 6,414.85 | 43,033.16 | 44,966.10 |
| December | 7,430.44 | 53,400.83 | 43,692.88 |
| | 90,414.35 | 425,083.35 | 580,775.31 |

(17) That the production by years, from Section 16 during the period from 1910 to 1919, both inclusive, was as follows:

Section 16.

| Year. | Production in Bbls. |
|---|---|
| 1910 | 90,414 |
| 1911 | 425,083 |
| 1912 | 580,775 |
| 1913 (1/1–3/1) | 84,513 |
| 1913 (3/1–12/31) | 308,828 |
| 1914 | 315,130 |
| 1915 | 193,832 |
| 1916 | 176,509 |
| 1917 | 144,675 |
| 1918 | 106,799 |
| 1919 | 103,500. |

(18) That attached hereto as 'Exhibit F' is a true and correct copy of the corporation Income Tax Return filed by the Petitioner March 27, 1918, for the calendar year 1917.

(21) That attached hereto as 'Exhibit G' is a true and correct copy of the corporation Excess Profits Tax Return filed by the Petitioner on March 27, 1918, for the calendar year 1917.

(22) That the sixty day letter attached to the

petition for 1917 may be considered in evidence for the purpose of showing the basis for computing the deficiency therein asserted.

(23) That the sixty day letter attached to the petition for 1918 and 1919 may be considered in evidence for the purpose of showing the basis for computing the deficiency therein asserted.

[131] (24) That attached hereto as 'Exhibit H' is a true and correct copy of a contract dated January 1, 1916, by and between North American Oil Consolidated as Party of the First Part and Chas. S. Wheeler and John F. Bowie (co-partners), Attorneys at Law, as Parties of the Second part, and that said copy may be considered in evidence in lieu of the original.

(25) That the following amounts, which represent 4% of the gross production from Section 2 sold in 1917, 1918 and 1919 respectively, were turned over to Messrs. Wheeler and Bowie, in accordance with the contract dated January 1st, 1916, a copy of which is attached hereto as 'Exhibit H':

| Year | Proceeds |
|---|---|
| 1917 | $20,441.18 |
| 1918 | 21,730.60 |
| 1919 | 27,136.91. |

(26) That in the return for 1917 the sum of $35,795.54 was deducted on account of said contract with Messrs. Wheeler & Bowie, said amount representing accruals for both 1916 and 1917.

(27). That in the return for 1918, the sum of $21,730.60 was deducted on account of said contract with Messrs. Wheeler & Bowie.

(28) That in the return for 1919, the sum of $27,136.91 was deducted on account of said contract with Messrs. Wheeler & Bowie.

(Signed) CHARLES D. HAMEL,
LEE I. PARK,
Attorneys for Petitioner.
(Signed) A. W. GREGG,
AGB.,
Attorney for Respondent."

[132] "RESPONDENT'S STIPULATION OF FACTS.

"(1) The Petitioner acquired Section 2, T. 32 S. R. 23 E., M. D. B. & M., Kern County California, by purchase on July 15, 1913.

(2) That there is attached hereto as 'Exhibit 1' true and correct copy of Patent issued by the United States on April 12th, 1922, to all of Section 2 in T. 32 S. R. 23 E., M. D. B. & M., and it is stipulated that the same may be considered in evidence with the same force and effect as the original thereof.

(3) That attached hereto as 'Exhibit 2' is a true and correct copy of the order appointing a Receiver in the case of the United States of America vs. North American Oil Consolidated, and others, Equity A–48, in the District Court of the United States for the Southern District of California, Northern Division, and that such copy may be considered in evidence in lieu of the original.

(4) That attached hereto as 'Exhibit 3' is a true and correct copy of the final decree, dated June 5,

1917, in the case of the United States of America vs. North American Oil Consolidated and others, Equity A–48, in the District Court of the United States for the Southern District of California, Northern Division, and that such copy may be considered in evidence in lieu of the original.

(5) That attached hereto as 'Exhibit 4' is a true and correct copy of Mandate from the United States Supreme Court to the United States Circuit Court of Appeals for the Ninth Circuit, in the case of United States of America vs. North American Oil Consolidated and others, and that said copy may be considered in evidence in lieu of the original.

[133] (6) That at all times during said Receivership said Section 2 was in the physical possession of and operated by North American Oil Consolidated.

(7) That at all times during said Receivership the income from oil produced on said Section 2 was entered on the books of the North American Oil Consolidated as its income.

(8) That attached hereto as 'Exhibit 5' is the original corporation income tax return filed by the North American Oil Consolidated on February 27, 1917, for the calendar year 1916, with leave to respondent to withdraw the original and substitute photostatic copy.

(9) That attached hereto as 'Exhibit 6' is the amended corporation income tax return filed by the North American Oil Consolidated on March 27, 1918, for the calendar year 1916, with leave to

respondent to withdraw the original and substitute photostatic copy.

(10) That the net income impounded in the hands of the Receiver from Section 2, T. 32 S. R. 23 E. M. D. B. & M., Kern County, California, during the period from February 2, 1915, to December 31, 1916, and released in June, 1917, by the final decree of the United States District Court for the Southern District of California, Northern Division, vacating the order appointing the Receiver, was $171,979.22, of which $10,126.04 was turned over to Messrs. Wheeler and Bowie in accordance with the terms of the contract dated January 1, 1916, between petitioner and said Messrs. Wheeler and Bowie, a copy of said contract being attached to Petitioner's Stipulation of Facts as 'Exhibit H.'

[134] (11) That attached hereto as Exhibits 7, 8, 9, 10 and 11 are income and profits tax waivers for the calendar year 1917, filed by the North American Oil Consolidated, petitioner herein, with the Commissioner of Internal Revenue on January 26, 1923, January 10, 1924, January 17, 1924, December 22, 1924, and December 2, 1925, respectively, and that said copies may be received in evidence in lieu of the originals.

(12) That in computing petitioner's invested capital and depletion allowances for the years 1917, 1918 and 1919, the Commissioner added to the capital sum remaining in 1916, as shown in copy of Valuation Report dated July 30, 1925, and attached hereto as Exhibit 12 the sum of $287,687.03 representing the capitalized cost of wells developed on

Section 16, T. 32 S. R. 23 E., during the year 1916; that said sum of $287,687.03 was expended by petitioner in drilling wells during the years 1910 and 1911 as follows: $51.727.64 in the year 1910 and $235,959.39 in the year 1911; and that said sums should have been added to the capital count during the years 1910 and 1911 instead of during the year 1916. Copy of Valuation Report dated July 30, 1925, attached hereto and marked Exhibit 12, is hereby stipulated in evidence solely for the purpose of showing respondent's computation of invested capital and depletion allowances.

(Signed) CHARLES D. HAMEL,
LEE I. PARK,
Attorneys for Petitioner.
(Signed) A. W. GREGG,
A. G. B.,
Attorney for Respondent."

[135] Following receipt of the foregoing stipulations in evidence, Exhibits 5, 6, and "F," were offered and received in evidence, copies of the same being hereto attached and made a part of this statement of evidence as if fully set forth herein. The foregoing is all of the evidence deemed material to this appeal and introduced in this cause.

The petitioner, Commissioner of Internal Revenue, tenders and presents the foregoing as a statement of the evidence in this case and prays that the same may be approved by the United States Board of Tax Appeals and made a part of the record in this case.

C. M. CHAREST.

F.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

The foregoing statement of evidence is approved this 23d day of October, 1930.

C. ROGERS ARUNDELL,
Member, United States Board of Tax Appeals.

ERC:LLD
10/11/30

United States of America

Treasury Department

May 25, 1917.

Pursuant to Section 882 of the Revised Statutes, I hereby certify that the annexed are true copies of "Original" and "Amended" Corporations Returns of Annual Net Income for the year ended December 31, 1916, filed by North American Oil Consolidated, San Francisco, California; Letter dated March 23, 1918 to Justus S. Marshall, Esq., Collector of Internal Revenue, San Francisco, California, from North American Oil Consolidated, on file in this Department.

In witness whereof, I have hereunto set my hand, and caused the seal of the Treasury Department to be affixed, on the day and year first above written.

By direction of the Secretary.

Chief
Assistant Secretary.

TREASURY DEPARTMENT

TO BE FILLED IN BY INTERNAL REVENUE BUREAU.

Audited by .....

In .....

Form 1031.
(Revised October, 1916.)

# INCOME TAX.

## THE PENALTY

FOR FAILURE TO HAVE THIS RETURN IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE WITHIN THE TIME REQUIRED BY LAW IS NOT MORE THAN $10,000 AND THE ASSESSMENT IS INCREASED FIFTY PER CENT.

## RETURN OF ANNUAL NET INCOME

(Title I, Parts II and III, of the Act of September 8, 1916.)

# CORPORATIONS.

(OTHER THAN INSURANCE COMPANIES.)

TO BE FILLED IN BY COLLECTOR.

Collection District .....

Assessment List 23-1 ..... (Month) ....., 1917.

Page ..... Line .....

**IMPORTANT.**

Read this form and all instructions carefully and fill in supplementary statement before making entries in return proper. Totals in supplementary statement must agree with totals in return.

Above space to be stamped by Collector, showing district and date filed.

**RETURN OF NET INCOME** for the { Calendar / Fiscal } year ended ....., 191.

by ..... (Name of corporation, joint-stock company, or association.) ....., (Kind of business.)

and located at ..... (Street and number.) ....., ..... (City or town.) ....., ..... (State.)

(The address given must be that of the principal place of business of the corporation.)

**If no figures are to be extended opposite any item in the return, the word "None" should be inserted.**

1. Total amount of paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital, other than interest-bearing indebtedness, employed in the business at the close of the year ..... $

2. Total amount of bonded and other interest-bearing indebtedness outstanding at close of year, exclusive of indebtedness wholly secured by collateral, the subject of sale or hypothecation in ordinary business of the corporation ..... $

| GROSS INCOME: | Dollars. | Cts. |
|---|---|---|
| (a) From operations ..... | $ | |
| (b) From rentals ..... | | |
| (c) From interest ..... | | |
| (d) From dividends received ..... | | |
| (e) From other sources ..... | | |
| Total gross income ..... | $ | |
| Total deductions ..... | | |
| Net income ..... | $ | |
| Tax at 2% ..... | $ | |
| | $ | |
| | $ | |

| DEDUCTIONS. | Dollars. | Cts. |
|---|---|---|
| 4. (a) Expenses, general ..... | $ | |
| (b) Payments in lieu of rent ..... | | |
| 5. (a) Losses sustained charged off ..... | | |
| (b) Depreciation charged off ..... | | |
| (c) Depletion charged off ..... | | |
| 6. (a) Interest paid (see Note 6a) ..... | | |
| (b) Interest paid by banks on deposits ..... | | |
| 7. (a) Taxes, domestic paid ..... | | |
| (b) Taxes, foreign paid ..... | | |
| Total deductions ..... | $ | |

I, ....., President (or other officer) of the ....., being severally duly sworn, each for himself, deposes and says that the statements contained in the supplementary statement and in any additional list or lists attached hereto or accompanying same, are, to the best of his knowledge and belief, true and correct in each and every particular.

Subscribed and sworn before me this ..... day of ....., 191.

.....
(Official capacity.)

.....
President.

.....
Treasurer.

## GENERAL INSTRUCTIONS.

Returns made on the basis of a calendar year must be filed on or before March 1 with the Collector of Internal Revenue at the district in which is located the principal place of business of the corporation; if made on the basis of a FISCAL YEAR they must be filed within 60 days after the close of such year.

Any corporation desiring to make returns of annual net income on the basis of a fiscal year other than the calendar year must, not less than 30 days prior to the time when the return would be due if made on the calendar year basis, file with the Collector a notice in writing designating the last day of some month as the close of its fiscal year. A return for that portion of the calendar year ending with the date designated as the close of the fiscal year must be filed on or before the sixtieth day thereafter, and the return for each full fiscal year thereafter must be filed within 60 days after the closing date of the fiscal year so established.

Collectors may, in the case of neglect to file the return within the prescribed time, the Collector is authorized to grant an extension of the filing period not exceeding thirty days, provided such neglect was due to absence or sickness and provided an application for such extension is made in writing prior to the expiration of the time for which extension may be granted. In meritorious cases the Commissioner is authorized to grant such further extension as he may deem proper.

Signature.—Returns must be signed and verified by two officers of the corporation, that is, by the president, vice president, or other principal officer, and by the treasurer or other financial officer, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have one, affixed on the return in the space provided for that purpose.

Subsidiary companies.—The corporation making this return should attach hereto a list of all its subsidiary companies, if any, with the location of the principal place of business of each. Each subsidiary company must make a separate and distinct return.

Foreign corporations.—Foreign corporations subject to the law are required to make returns to the Collector of the District in which is located the principal place of business or agency through which is transacted the business in the United States, or if the corporation has no place of business or agency in the United States, its return will be made to the Collector of Internal Revenue at Baltimore, Maryland. The gross income to be returned is that received from business transacted and capital invested in the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including income derived from dividends on the stock or from net earnings of resident corporations, joint-stock companies, or associations whose net income is taxable under this law. The deductions allowable are those actually paid within the year and necessary to the transaction of the business in this country, all as specifically set out in the Act. Foreign taxes are not deductible from gross income arising and accruing to a foreign corporation from business done or capital invested in the United States. In the case of a foreign corporation having no place of business or agency in the United States and no return is made, the tax on income from interest and dividends will be withheld at the source.

Penalties.—Corporations refusing or neglecting to file returns within the time prescribed by law or rendering false or fraudulent returns shall be liable to a penalty of not more than $10,000, and an additional tax of 50 per cent in case of neglect to file the return within the time prescribed by law, and 100 per cent in the case of a false or fraudulent return. The penalty provided in case of delinquency, if the return is voluntarily filed without notice from the Collector, and it is shown that

(Street and number.) (City or town.) (State.)

(The address given must be that of the principal place of business of the corporation.)

If no figures are to be extended opposite any item in the return, the word "None" should be inserted.

1. Total amount of paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital, other than interest-bearing indebtedness, employed in the business at the close of the year ..... $

2. Total amount of bonded and other interest-bearing indebtedness outstanding at close of year, exclusive of indebtedness wholly secured by collateral, the subject of sale or hypothecation in ordinary business of the corporation ..... $

| GROSS INCOME: | Dollars. | Cts. |
|---|---|---|
| (a) From operations | $ | |
| (b) From rentals | | |
| (c) From interest | | |
| (d) From dividends received | | |
| (e) From other sources | | |
| Total gross income | $ | |
| Total deductions | | |
| [illegible] | $ | |
| [illegible] at 2% | $ | |
| | $ | |
| | $ | |

| DEDUCTIONS. | Dollars. | Cts. |
|---|---|---|
| 4. (a) Expenses, general | $ | |
| (b) Payments in lieu of rent | | |
| 5. (a) Losses sustained charged off | | |
| (b) Depreciation charged off | | |
| (c) Depletion charged off | | |
| 6. (a) Interest paid (see Note 6a) | | |
| (b) Interest paid by banks on deposits | | |
| 7. (a) Taxes, domestic paid | | |
| (b) Taxes, foreign paid | | |
| Total deductions | $ | |

[illegible] of the [illegible] of [illegible], being duly sworn, each for himself, deposes and says that [illegible] contained in the supplementary statement and in any additional list or lists attached to or accompanying [illegible] is, to the best of [illegible] knowledge and belief, true and correct in each and every particular.

Subscribed before me this 26th day of February, 1917

C. B. Tennilons
Notary Public.
(Official capacity.)

J. E. Kinneff, Vice President.

C. F. Rauer, Secretary-Treasurer.

## GENERAL INSTRUCTIONS.

Returns made on the basis of a calendar year must be filed on or before March 1 with the Collector of Internal Revenue of the district in which the principal office of business of the corporation; if made on the basis of a FISCAL YEAR* they must be filed within 60 days after the close of such year.

If the corporation is changing its method of annual net income on the basis of a fiscal year other than the calendar year must, not less than 30 days prior to the time when the return would be due if made on the calendar year basis, file with the Collector a notice in writing designating the last day of some month as the close of its fiscal year. A return for that portion of the calendar year ending with the date designated as the close of the fiscal year must be filed on or before the last day of the first fiscal year, and the return for each full fiscal year thereafter must be filed within 60 days after the closing date of the fiscal year so established.

In the case of neglect to file the return within the prescribed time, the Collector is authorized to grant an extension of the filing period not exceeding sixty days, provided such neglect was due to absence or sickness and provided an application for such extension is made in writing prior to the expiration of the time for which extension may be granted. In meritorious cases the Commissioner is authorized to grant such further extension as he may deem proper.

Signatures.—Returns must be signed and verified by two officers of the corporation, that is, by the president, vice president, or other principal officer, and by the treasurer or other financial officer, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, affixed on the return in the space provided for that purpose.

Subsidiary companies.—The corporation making this return should attach hereto a list of all its subsidiary companies, if any, with the location of the principal place of business of each. Each subsidiary company must make a separate and distinct return.

Foreign corporations.—Foreign corporations subject to the law are required to make returns to the Collector of the District in which is located the principal place of business through which is transacted the business in the United States, or if the corporation has no place of business or agency in the United States, its return will be made to the Collector of Internal Revenue at Baltimore, Maryland. The gross income to be returned is that received from business transacted and capital invested in the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including income derived from dividends on stock of corporations, and earnings of resident corporations, joint-stock companies, or associations whose net income is taxable under this law. The deductions allowable are those actually paid within the year for such proportion of the necessary and ordinary expenses, including rentals or payments in lieu of rentals, as are fairly applicable to the business transacted and necessary to the transaction of the business in this country, all as specifically set out in the Act. Foreign taxes are not deductible from gross income arising and accruing to a foreign corporation from business done or capital invested in the United States. In the case of a foreign corporation having no place of business or agency in the United States and no return is made, the tax on income from interest and dividends will be withheld at the source.

Penalties.—Corporations refusing or neglecting to file returns within the time prescribed by law or rendering false or fraudulent returns shall be liable to a penalty of not less than $1,000, and an additional tax of 50 per cent in case of neglect to file the return within the time prescribed by law, and 100 per cent in the case of a false or fraudulent return, which sum shall be added to the assessment; provided in case of delinquency, if the return is voluntarily filed without notice from the Collector, and it is shown that the delay was due to reasonable cause and not to willful neglect, the 50 per cent additional tax will not be assessed.

Any officer of any corporation required by law to make, render, sign, or verify any return, who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required to be made shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

## SUPPLEMENTARY STATEMENT.

The following information must be furnished by every corporation, joint-stock company, or association, without which the return will not be accepted as complete. The items herein relate to the items listed in the above return form and bear corresponding numbers, and the totals set out in the above return must agree with the totals hereinafter set out.

1. PAID-UP CAPITAL STOCK:

Unissued or treasury stock should not be included in this item, but only such stock as has been actually issued and is outstanding at the close of the year and for which payment has been received. Where the stock issued is payable in installments or assessments, only so much of it as has been actually paid in upon such installments or assessments should be reported.

If no capital stock is issued or if the capital stock is issued without par value, the amount of capital invested in the business at the close of the year, not including borrowed capital, will be entered under this item.

(a) Paid-up "common stock" .....

(b) Paid-up "preferred stock" .....

Total paid-up stock .....

or (c) Capital employed in business .....

2. INDEBTEDNESS:

All interest bearing indebtedness for the payment of which the corporation or its property is bound, should be reported below. In the case of banking corporations and like financial institutions, deposits should not be reported as indebtedness. Indebtedness wholly secured by collateral, the subject of sale or hypothecation in the ordinary business of the corporation, should be reported here, but such indebtedness must not be entered under Item 2 above nor be considered in determining the amount of interest deductible under Item 6 (a).

| Character of obligation. | Rate of interest. | Principal. |
|---|---|---|
| | | |
| | | |
| | | |

a-2 . a

SUPPLEMENTARY STATEMENT

4. Gross Income:

All manufacturing, mercantile, or other corporations which ... gain or loss by inventory are required to state the ... gross annual income or loss is determined otherwise. ... stated in the space provided therefor. In case the annual gain ... inventory, merchandise must be inventoried at the cost price ... will ultimately be reflected in the sales during the year which ... closed.

(a) Gross Operations:

For Inventory—

| | | | |
|---|---|---|---|
| Sales during year | $ | | |
| Stock on hand at close of year | | | |
| Total | | | $ |
| Purchases during year | $ | | |
| Stock on hand at beginning of year | | | |
| Total | | | $ |
| Total gain or loss [5 (a), first page] | | | $ |

In the case of manufacturing corporations, "Purchases during the year" will ... in stock of the cost of goods, finished or unfinished, sold or unsold, as has ... been improperly deducted under any item of the return. ... Overhead charges should not be included in inventory (see item 6).

If inventory shows loss, make entry in red ink or strike out "gain".

If inventory is not used, state below method of determining gain or loss from ... Total sales of coal for year

If the sale of capital assets acquired prior to March 1, 1913, the profit or ... determined will be the difference between the fair market value of such ... March 1, 1913, and the price at which they are sold. If acquired subse- ... 1913, then the profit or income to be returned is the difference ... and the selling price.

In case of the sale of capital acquired prior to March 1, 1913, state—

(1) Original cost of assets ..... $

(2) Fair market price or value as of March 1, 1913 .....

(3) Sales which assets were sold .....

State how the fair market price or value as of March 1, 1913, was determined:

(b) Interest will include all payments received in cash or its ... other property owned by the corporation making ... received.

Dividends includes all interest received on bonds or securi- ... with the exception of interest on obligations of a State ... or interest upon the obligations of the United States ... interest for the purpose of information should be ...

(c) Rents and other collections.

| | Amount of principal. | Rate. | Amount of interest received. |
|---|---|---|---|
| | $ | | $ |
| | | | |
| | | | |
| | | | |
| | $ | | $ |

... to be made by a corporation out of its earnings ... shares in each year of the paying corp- ... and such sums value is held to be the proportionate ... the paying corporation since March 1, 1913, as is ... declared or ordered to be distributed to the receiving ...

... from which income has been received, and the amount thereof.

| | | | |
|---|---|---|---|
| | $ | | |
| | | | |
| | | | |
| | | | |
| | $ | | |

... includes only the ordinary and necessary expenses paid within the ... maintenance and operation of the business and properties of the corpora- ... for unpaid salaries, rent will not include any disbursements to the ... is specifically provided for in the return form proper on the obverse ...

... indebtedness wholly secured by property collateral the subject of ... in the ordinary business of the corporation as a dealer only in ... securities made collateral or in the issuing of funds thereby produced. ... deduction as a business expense to an amount of the interest paid on ... not in excess of the actual value of the collateral securing it.

... of material, labor, fuel, and other items entering into the cost of ... sold, or investments are deductible under this head as expenses. ... such items have not been considered in determining the cost or purchase ... when the income derived from operations is ascertained through an ... as set out in Item 5 (a) of this statement.

... the incidental repairs which do not add to the value or appreciably ... life of property are deductible as expenses, but expenditures for new ... permanent improvements or betterments which increase the value of prop- ... restoring or replacing property, are not deductible under this or any other ... return. Such expenditures are properly chargeable to capital account, to ... through annual depreciation allowances.

... made to officers or employees who are stockholders, which payments are ... in the form of salaries or compensation and the amount of which is based upon ... services of such officers or employees, are not deductible as a business ... expense.

... $ 2 [illegible]

... $1,000 per year ... per cent for 1916) on the ... to be filed, in which case the tax ... exemption claimed. The tax so ... together with all certificates of ... later than March 1.

Notwithstanding the withholding of the tax at the ... individual receiving income from ... $3,000 must also make returns on Form 1040.

(b) Payments in Lieu of Rent.

This item should include all royalties and other charges, including any interest ... which the corporation is required to make for the right to use and possess ... property in which it has no title, interest, or equity. See Note 6 (a).

(c) Losses.

Losses deductible under this item must be distinguished from depreciation or ... allowances for exhaustion, wear and tear. The losses must be absolute, complete, ... actually sustained during the year and charged off on the books of the corporation, ... and if the losses result from the sale of assets acquired prior to March 1, 1913, such ... losses shall be ascertained by taking the difference between the fair market price or ... value as of March 1, 1913, and the selling price.

Losses compensated by insurance or otherwise are not deductible.

| Kind of asset | Original amount. | Date charged off. | Amount charged off. |
|---|---|---|---|
| [illegible] | $ | | |
| | | | |
| | | | |
| Total | | | $ |

When were the deducted losses ascertained to be such? [illegible]

How were they so ascertained? [illegible]

In case of losses resulting from the sale of capital assets acquired prior to March 1, 1913, state—

(1) Original cost of assets ..... [illegible]

(2) Fair market price or value as of March 1, 1913 .....

(3) Loss resulting from such sale .....

State also how the fair market price or value as of March 1, 1913, was ascertained.

Coal Lands Appreciation. Mill Depletion Charged off

(d) Depreciation:

The amount deductible on account of depreciation ... fairly measures the loss during the year in the value ... of exhaustion, wear and tear. Such amount should ... the cost of the property and the probable number ... Stocks, bonds, and like securities, as well as any ... subject to exhaustion, wear and tear within the ... amount charged off as representing a shrinkage in ... deductible either as depreciation or loss.

Depreciation computed on total previous ... allowable deduction, since any loss due to ... merchandise will be reflected in the sales during the ...

| Kind of property. | Its cost. | Probable life of ... |
|---|---|---|
| [illegible] | $ | |
| | | |
| | | |
| Total | $ | |

If buildings, state kind of construction.

(e) Depletion:

Depletion applies to the extraction of natural ... tion to return to the corporation the capital ... March 1, 1913, an amount equivalent to ... of such deposits as of that date. As ...

| *Kind of property. | Its cost if acquired subsequent to March 1, 1913. | †Fair market value as of March 1, 1913. |
|---|---|---|
| Coal | $ | $ |
| | | |
| | | |
| | | |

*Coal, iron ore, copper, oil, or gas.
†State how fair market value as of March 1, 1913 was ascertained.

Coal Lands Appreciation Charged off

6. (a) Interest Deductible:

The amount of interest deductible under this head is the amount actually paid within the year on an amount of bonded or other indebtedness not exceeding ... paid-up capital stock outstanding at the close of the year, ... active amount of capital (not including interest-bearing indebtedness) ... the business at the close of the year, plus, in each case, outstanding ... bearing indebtedness also then outstanding.

Capital employed in the business, as here used, ... paid in by the members of the company, including ... as is not in excess of the needs of the business, but does not include any borrowed capital or interest-bearing indebtedness.

Interest, so-called, or dividends paid upon preferred capital stock is not deductible.

Interest deductible under this head includes all interest actually paid within the year not in excess of the limit hereinbefore indicated on any debt for which the corporation or any property in which it has title, interest, or equity is pledged, except interest on indebtedness wholly secured by collateral the product of sale or liquidation in the ordinary business of the company, etc., which interest is deductible under Item 4 (b) as a business expense.

INTEREST PAYMENTS ACTUALLY MADE DURING YEAR.

All forms of indebtedness upon which interest was paid should be listed here.

| Name or kind of obligation. | Amount of principal. | Date of interest. | Amount of interest paid. |
|---|---|---|---|
| | $ | | $ |

(If inventory shows loss, make entry in red ink or strike out "gain.")

If inventory is not used, state below method of determining gain or loss from sales:

Total sales of coal for year

(a) In the sale of capital assets acquired prior to March 1, 1913, the profit or loss is to be the difference between the fair market value of such assets on March 1, 1913, and the price at which they are sold. If acquired subsequent to March 1, 1913, then the profit or income to be returned is the difference between the cost and the selling price.

(b) In case of the sale of capital acquired prior to March 1, 1913, state—

(1) Original cost of assets.....

(2) Fair market price or value as of March 1, 1913.....

(3) Date which assets were sold.....

State also how the fair market price or value as of March 1, 1913, was determined:

.....

.....

.....

TO BE FILED IN INTERNAL REVENUE BUREAU

Form 1031

TO BE FILLED IN BY COLLECTOR

# INCOME TAX.

THE PENALTY

FOR FAILURE TO HAVE THIS RETURN IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE WITHIN THE TIME REQUIRED BY LAW IS NOT MORE THAN $10,000 AND THE ASSESSMENT IS INCREASED FIFTY PER CENT

## RETURN OF ANNUAL NET INCOME.

(Title I, Parts II and III, of the Act of September 8, 1916.)

IMPORTANT.

Read this form and all instructions carefully and fill in supplementary statement before making entries in return proper. Totals in supplementary statement must agree with totals in return.

Above space to be filled in by Collector, showing disposition and date filed.

# CORPORATIONS.

(OTHER THAN INSURANCE COMPANIES.)

Amended RETURN OF NET INCOME for the Calendar / Fiscal year ended , 191

by (Name of corporation, joint-stock company, or association) , (Kind of business.)

and located at (Street and number) (Town) (State.)

(The address given must be that of the principal place of business of the corporation.)

**If no figures are to be extended opposite any item in the return, the word "None" should be inserted.**

| | | Dollars | Cts. |
|---|---|---|---|
| 1. Total amount of paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital, other than interest-bearing indebtedness, employed in the business at the close of the year | $ | 1 [illegible] | 50. |
| 2. Total amount of bonded and other interest-bearing indebtedness outstanding at close of year, exclusive of indebtedness wholly secured by collateral, the subject of sale or hypothecation in ordinary business of the corporation | $ | [illegible] | |

| 3. Gross income: | Dollars | Cts. |
|---|---|---|
| (a) From operations | $ [illegible] | |
| (b) From rentals | [illegible] | |
| (c) From interest | [illegible] | |
| (d) From dividends received | [illegible] | |
| (e) From other sources | [illegible] | |
| Total gross income | $ [illegible] | |
| Total deductions | [illegible] | |
| 3. Net income | $ 27 598 14 | |
| 3a. Tax assessable at 2% | $ [illegible] | |
| | $ [illegible] | |
| Total | $ [illegible] | |

| DEDUCTIONS. | Dollars | Cts. |
|---|---|---|
| 4. (a) Expenses, general | $ 126 402 | 16 |
| (b) Payments in lieu of rent | 15 800 | 00 |
| 5. (a) Losses sustained charged off | 102 240 | 73 |
| (b) Depreciation charges off | 64 716 | 26 |
| (c) Depletion charged off | 12 2 20 | 76 |
| 6. (a) Interest paid (see Note 6a) | 44 222 | 07 |
| (b) Interest paid by banks on deposits | None | |
| 7. (a) Taxes, domestic paid | 7 197 | 95 |
| (b) Taxes, foreign paid | None | |
| Total deductions | $ 44 3 196 | 19 |

[illegible], President, and [illegible], Treasurer, of the [illegible] whose return of net income is herein set forth, being severally duly sworn, each for himself, deposes and says that he has examined the foregoing report and in the supplementary statement and in any additional list or lists attached to or accompanying the same, to the best knowledge and belief, true and correct in each and every particular.

Subscribed and sworn to before me this 26th day of March, 191[illegible]

D. D. Brown

(Official capacity.)

President.

C. F. [illegible] Secretary.
Treasurer.

## GENERAL INSTRUCTIONS.

Time of filing returns.—Returns made on the basis of a calendar year must be filed on or before March 1 with the Collector of Internal Revenue of the district in which is located the principal place of business of the corporation; if made on the basis of a FISCAL YEAR* they must be filed within 60 days after the close of such year.

Corporations desiring to make returns of annual net income on the basis of a fiscal year other than the calendar year must, not less than 30 days prior to the time when the return would be due if made on the calendar year basis, file with the Collector a notice in writing designating the last day of some month as the close of their fiscal year. A return for that portion of the calendar year ending with the date designated as the close of the fiscal year must be filed on or before the [illegible] of the next calendar year, and the return for each full fiscal year thereafter must be filed within 60 days after the closing date of the fiscal year so established.

Extension of time.—In the case of neglect to file the return within the prescribed time, the Collector is authorized to grant an extension of the filing period not exceeding [illegible] from the normal due date, provided such neglect was due to sickness and provided an application for such extension is made in writing prior to the expiration of the period for which extension may be granted. In meritorious cases the Commissioner is authorized to grant such further extension as he may deem proper.

Signature and verification.—Returns must be signed and verified by two officers of the corporation, that is, by the president, vice president, or other principal officer, [illegible] or other financial officer, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have [illegible] affixed on the return in the space provided for that purpose.

Consolidated returns.—The corporation making this return should attach hereto a list of all its subsidiary companies, if any, with the location of the principal place of business of each. Each subsidiary company must make a separate and distinct return.

Foreign corporations.—Foreign corporations subject to the law are required to make returns to the Collector of the District in which is located the principal place of business or agency through which is transacted the business in the United States, or if the corporation has no place of business or agency in the United States, its return will be filed with the Collector of Internal Revenue at Baltimore, Maryland. The gross income to be returned is that received from business transacted and capital invested in the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies, or associations whose net income is taxable under this law. The deductions allowable are those taxes and disbursements incident and necessary to the transaction of the business in this country, all as specifically set out in the Act. Foreign taxes are not deductible from the gross income arising and accruing to a foreign corporation from business done or capital invested in the United States. In the case of a foreign corporation having no place of business or agency in the United States and no return is made, the tax on income from interest and dividends will be withheld at the source.

Penalties.—Corporations refusing or neglecting to file returns within the time prescribed by law or rendering false or fraudulent returns shall be liable to a penalty of not [illegible] and an additional tax of 50 per cent in case of neglect to file the return within the time prescribed by law, and 100 per cent in the case of a false or fraudulent return shall be added to the assessment; provided in case of delinquency, if the return is voluntarily filed without [illegible] Collector, and it is shown that [illegible] reasonable cause and not to willful neglect, the 50 per cent additional tax will not be assessed.

[illegible] any false, fictitious, or fraudulent return or statement with intent to defeat [illegible] shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both.

Office located at Fish Market Block, Norfolk, Virginia

(Street and number) (City or town) (State.)

(The address given must be that of the principal place of business of the corporation.)

If no figures are to be extended opposite any item of the return, the word "None" should be inserted.

| | | |
|---|---|---|
| 1. Total amount of paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital, other than interest-bearing indebtedness, employed in the business at the close of the year | $ | 1,000,000.00 |
| 2. Total amount of bonded and other interest-bearing indebtedness outstanding at close of year, exclusive of indebtedness wholly secured by collateral, the subject of sale or hypothecation in ordinary business of the corporation | $ | 600,000.00 |

| 3. GROSS INCOME: | Dollars | Cts. | DEDUCTIONS. | Dollars | Cts. |
|---|---|---|---|---|---|
| (a) From operations | $ 1,146,111 | 71 | 4. (a) Expenses, general | $ 126,403 | 14 |
| (b) From rentals | 2,796 | 75 | (b) Payments in lieu of rent | 15,600 | 00 |
| (c) From interest | 2,244 | 67 | 5. (a) Losses sustained charged off | 102,240 | 73 |
| (d) From dividends received | | | (b) Depreciation charged off | 64,716 | 36 |
| (e) From other sources | 2,349 | 40 | (c) Depletion charged off | 123,206 | 20 |
| Total gross income | $ 1,153,602 | | 6. (a) Interest paid (see Note 6a) | 113,222 | 07 |
| Total deductions | 1,153,602 | | (b) Interest paid by banks on deposits | None | |
| 8. Net income | $ 27,592 | 14 | 7. (a) Taxes, domestic paid | 7,107 | 05 |
| 9. Tax assessable at 2% | $ | | (b) Taxes, foreign paid | None | |
| | $ | | Total deductions | $ 1,153,196 | 19 |
| Total | $ | | | | |

[illegible], President, and [illegible], Treasurer, of the [illegible], whose return of net income is herein set forth, being severally duly sworn, each for himself, deposes and says that he has examined the foregoing report and in the supplementary statement and in any additional list or lists attached to or accompanying the same, to the best knowledge and belief, true and correct in each and every particular.

Sworn to and subscribed before me this 26th day of March, 1917

[illegible]

(Official capacity.)

[illegible]
President.

[illegible]
Secretary-Treasurer.

## GENERAL INSTRUCTIONS.

Time of filing returns.—Returns made on the basis of a calendar year must be filed on or before March 1 with the Collector of Internal Revenue of the district in which is located the principal place of business of the corporation; if made on the basis of a FISCAL YEAR* they must be filed within 60 days after the close of such year.

Fiscal years.—Corporations desiring to make returns of annual net income on the basis of a fiscal year other than the calendar year must, not less than 30 days prior to March 1 of the year in which the return would be due if made on the calendar year basis, file with the Collector a notice in writing designating the last day of some month as the close of such fiscal year. A return for that portion of the calendar year ending with the date designated as the close of the fiscal year must be filed on or before the fifteenth day of the next calendar year, and the return for each full fiscal year thereafter must be filed within 60 days after the closing date of the fiscal year so established.

Extension of time.—In the case of neglect to file the return within the prescribed time, the Collector is authorized to grant an extension of the filing period not exceeding thirty days from the normal due date, provided such neglect was due to absence or sickness and provided an application for such extension is made in writing prior to the expiration of the period for which extension may be granted. In meritorious cases the Commissioner is authorized to grant such further extension as he may deem proper.

Signature and verification.—Returns must be signed and verified by two officers of the corporation, that is, by the president, vice president, or other principal officer, and by the treasurer or other financial officer, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, must be affixed to the return in the space provided for that purpose.

Subsidiary corporations.—The corporation making this return should attach hereto a list of all its subsidiary companies, if any, with the location of the principal place of business of each. Each subsidiary company must make a separate and distinct return.

Foreign corporations.—Foreign corporations subject to the law are required to make returns to the Collector of the District in which is located the principal place of business or agency through which is transacted the business in the United States, or if the corporation has no place of business or agency in the United States, its return will be rendered to the Collector of Internal Revenue at Baltimore, Maryland. The gross income to be returned is that received from business transacted and capital invested in the United States, including interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, and including income derived from dividends on capital stock or from net earnings of resident corporations, joint-stock companies, or associations whose net income is taxable under this law. The deductions allowable are those expenses and disbursements incident and necessary to the transaction of the business in this country, all as specifically set out in the Act. Foreign taxes are not deductible from the gross income arising and accruing to a foreign corporation from business done or capital invested in the United States. In the case of a foreign corporation having no place of business or agency in the United States and no return is made, the tax on income from interest and dividends will be withheld at the source.

Penalties.—Corporations refusing or neglecting to file returns within the time prescribed by law or rendering false or fraudulent returns shall be liable to a penalty of not exceeding $5,000, and an additional tax of 50 per cent in case of neglect to file the return within the time prescribed by law, and 100 per cent in the case of a false or fraudulent return shall be added to the assessment, provided in case of delinquency, if the return is voluntarily filed without notice from the Collector, and it is shown that delay in filing was due to reasonable cause and not to willful neglect, the 50 per cent additional tax will not be assessed.

Any officer of any corporation required by law to make, render, sign, or verify any return, who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required to be made shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

## SUPPLEMENTARY STATEMENT.

The following information must be furnished by every corporation, joint stock company, or association, without which the return will not be accepted as complete. The items herein relate to the items listed in the above return form and bear corresponding numbers, and the totals set out in the above return must agree with the totals hereinafter set out.

1. PAID-UP CAPITAL STOCK:

Unissued or treasury stock should not be included in this item, but only such stock as has been actually issued and is outstanding at the close of the year and for which payment has been received. Where the stock issued is payable in installments or assessments, only so much of it as has been actually paid in upon such installments or assessments should be reported.

If no capital stock is issued or if the capital stock is issued without par value, the amount of capital invested in the business at the close of the year, not including borrowed capital, will be entered under this item.

(a) Paid-up "common stock"

(b) Paid-up "preferred stock"

Total paid-up stock

or (c) Capital employed in business

2. INDEBTEDNESS.

All interest-bearing indebtedness, for the payment of which the corporation or its property is bound, should be reported below. In the case of banking corporations and like financial institutions, deposits should not be reported as indebtedness. Indebtedness wholly secured by collateral, the subject of sale or hypothecation in the ordinary business of the corporation, should be reported here, but such indebtedness must not be entered under Item 2 above nor be considered in determining the amount of interest deductible under Item 6 (a).

| Character of Obligation | Rate of interest | Principal |
|---|---|---|
| | | |
| | | |
| | | |

4-7

SUPPLEMENTARY STATEMENT Continued.

2. Gross Income

All manufacturing, mercantile, or other [illegible] gain or loss by inventory are required to state the [illegible] If the annual income or loss is determined otherwise than [illegible] stated in the space provided therefor. In case the [illegible] by inventory, merchandise must be inventoried at the cost price as [illegible] value will ultimately be reflected in the sales during the year [illegible] disposed of.

(a) Trade Operations:

Per inventory—

| | | |
|---|---|---|
| Sales during year | $ | |
| Stock on hand at close of year | | |
| Total | | $ |
| Purchases during year | $ | |
| Stock on hand at beginning of year | | |
| Total | | $ |
| Gross gain or loss [3 (a), first page] | | $ |

[illegible] of manufacturing corporations, "purchases during the year" will [illegible] month of the cost of goods, finished or unfinished sold or unsold, as has [illegible] deducted under any item of the return. [illegible] charges should not be included in inventory (see Item 4).

[illegible] inventory shows loss, make entry in red ink or strike out "gain.")

[illegible] inventory is not used, state below method of determining gain or loss from [illegible]:

Total sales of year

[illegible] of the sale of capital assets acquired prior to March 1, 1913, the profit or [illegible] will be the difference between the fair market value of such [illegible] 1, 1913, and the price at which they are sold. If acquired subse- [illegible] March 1, 1913, then the profit or income to be returned is the difference [illegible] and the selling price.

[illegible] case of the sale of assets acquired prior to March 1, 1913, state—

Original cost of assets $

Fair market price or value as of March 1, 1913

[illegible] which assets were sold

[illegible] market price or value as of March 1, 1913, was determined:

[illegible] income will include all payments received in cash or its [illegible] or other property owned by the corporation making [illegible] received.

[illegible] includes all interest received on bonds or securi- [illegible] the exception of interest on obligations of a State [illegible] or interest upon the obligations of the United States [illegible] for the purpose of information should be [illegible]

[illegible] and foreign corporations.

| | Amount of principal. | Rate. | Amount of interest received. |
|---|---|---|---|
| | $ | | $ |
| | | | |
| | | | |
| | | | $ |

[illegible] to be made by a corporation out of its earnings [illegible] cash or stock of the paying com- [illegible] to date. Stock dividends must be returned [illegible] such cash value is held to be the proportionate [illegible] paying corporation since March 1, 1913, as is [illegible] or allowed to be distributed to the receiving

[illegible] which income has been received, and the amount thereof.

| | | |
|---|---|---|
| Purchases | $ | 2 760 |
| [illegible] | | 50 [illegible] |
| | | |
| | | |

[illegible] include only the ordinary and necessary expenses paid within the [illegible] and operation of the business and properties of the corpora- [illegible] deductible below, and will not include any disbursements the [illegible] specifically provided for in the return form proper on the obverse

[illegible] wholly secured by property collateral the subject of [illegible] ordinary business of the corporation as a dealer only in [illegible] thereof or in the loaning of funds thereby produced, [illegible] as a business expense to an amount of the interest paid on [illegible] not in excess of the actual value of the collateral securing it.

[illegible] labor, fuel, and other items entering into the cost of [illegible] or inventoried are deductible under this head as expenses, [illegible] have not been considered in determining the cost or purchases [illegible] when the income derived from operations is ascertained through an [illegible] not set up in Item 3 (c) of this statement.

[illegible] for incidental repairs which do not add to the value or appreciably [illegible] life of property are deductible as expenses, but expenditures for new [illegible] permanent improvements or betterments which increase the value of prop- [illegible] restoring or replacing property, are not deductible under this or any other [illegible] Such expenditures are properly chargeable to capital account, to [illegible] through annual depreciation allowances.

[illegible] made to officers or employees who are stockholders, which payments are [illegible] in excess of salaries or compensation and the amount of which is based upon [illegible] of such officers or employees, are not deductible as a business [illegible]

| | | |
|---|---|---|
| (d) 1. Labor, wages, commissions, etc | $ | 12 [illegible] |
| 2. Fuel, light, power, etc | | 19 [illegible] |
| 3. Repairs (ordinary) | | 1 [illegible] |
| [illegible] | | 1 [illegible] |
| [illegible] wholly secured by collateral the | | [illegible] |

[illegible] from March 1, [illegible] receiving income from [illegible] must also make returns on Form 1040.

[illegible] this item should include [illegible] rentals and other charges, including any interest [illegible] payments which the corporation is required to make for the right to use and possess property in which it has no title, interest, or equity. See Note 6 (a).

5. (a) Losses:

Losses deductible under this item must be distinguished from depreciation or allowances for exhaustion, wear and tear. The losses must be absolute, complete, actually sustained during the year and charged off on the books of the corporation, and if the losses result from the sale of assets acquired prior to March 1, 1913, such losses shall be ascertained by taking the difference between the fair market price or value as of March 1, 1913, and the selling price.

Losses compensated by insurance or otherwise are not deductible.

| Kind of asset. | Original amount. | Date charged off. | Amount charged off. |
|---|---|---|---|
| [illegible] | $ | | $ |
| [illegible] | | | |
| [illegible] | | | |
| Total | | | |

When were the deducted losses ascertained to be such? [illegible]

How were they so ascertained? [illegible]

In case of losses resulting from the sale of capital assets acquired prior to March 1, 1913, state—

(1) Original cost of assets $

(2) Fair market price or value as of March 1, 1913

(3) Loss resulting from such sale

State also how the fair market price or value as of March 1, 1913, was ascertained:

(b) Depreciation:

The amount deductible on account of depreciation is an amount charged off which fairly measures the loss during the year in the value of physical property by reason of exhaustion, wear and tear. Such amount should be determined upon the basis of the cost of the property and the probable number of years constituting its life. Stocks, bonds, and like securities, as well as any other intangible assets, are not subject to exhaustion, wear and tear within the meaning of the law. Hence any amount charged off as representing a shrinkage in the value of such assets is not deductible either as depreciation or loss.

Depreciation computed on total invoice value of merchandise in stock is not an allowable deduction, since any loss due to the shrinkage in the salable value of the merchandise will be reflected in the sales when the merchandise is disposed of.

| Kind of property. | Its cost. | Probable life after acquirement. | Amount of depreciation. This year. | Amount of depreciation. Previous years. |
|---|---|---|---|---|
| [illegible] | | | $ | $ |
| [illegible] | | | | |
| [illegible] | | | | |
| Totals | | | | $ |

If buildings, state kind of construction.

(c) Depletion:

Depletion applies to the exhaustion of natural deposits, and contemplates a deduction to return to the corporation the capital invested, or in case of purchase prior to March 1, 1913, an amount sufficient to return to the corporation the fair market value of such deposits as of that date. An allowable deduction on account of depletion must not exceed the fair market value in the mine of the product thereof mined and sold during the year, and in case of oil or gas wells the amount deductible should be computed upon the basis of the decline in the settled flow. The amount sought to be deducted on this account must be charged off on the books of the company.

| *Kind of property. | Its cost if acquired subsequent to March 1, 1913. | †Fair market value as of March 1, 1913. | Amount of depletion. This year. | Amount of depletion. All years to date. |
|---|---|---|---|---|
| [illegible] | $ | $ | $ | $ |
| | | | | |
| | | | | |
| | | | | |

*Coal, iron ore, copper, oil, or gas.

†State how fair market value as of March 1, 1913, was determined.

6. (a) Interest Deductible:

The amount of interest deductible under this item is the amount actually paid within the year on an amount of bonded or other indebtedness not in excess of the paid-up capital stock outstanding at the close of the year, or if no capital stock, the entire amount of capital (not including interest-bearing indebtedness) employed in the business at the close of the year, plus, in each case, one-half of the interest-bearing indebtedness also then outstanding.

Capital employed in the business, as here used, contemplates the entire capital paid in by the members of the company, including so much of the accumulated surplus as is not in excess of the needs of the business, but does not include any borrowed capital or interest-bearing indebtedness.

Interest, so-called, or dividends paid upon preferred capital stock, is not deductible.

Interest deductible under this item includes all interest actually paid within the year not in excess of the limit hereinbefore indicated on any debt for which the corporation or any property in which it has title, interest, or equity is pledged, except interest on indebtedness wholly secured by collateral the subject of sale or hypothecation in the ordinary business of the company, etc., which interest is deductible under Item 4 (b) as a business expense.

INTEREST PAYMENTS ACTUALLY MADE DURING YEAR.

All forms of indebtedness upon which interest was paid should be listed here.

| Name or kind of obligation. | Amount of principal. | Rate of interest. | Amount of interest paid. |
|---|---|---|---|
| [illegible] | $ | % | $ |
| [illegible] | | % | |
| [illegible] | | % | |
| [illegible] | | % | |
| Total | $ | | $ |

...inventory shown here, make entry in red ink or strike out "gain.")

...inventory is not used, state below method of determining gain or loss from ...

Total sales of goods

...

...

...sale of capital assets acquired prior to March 1, 1913, the profit or ... will be the difference between the fair market value of such ... March 1, 1913, and the price at which they are sold. If acquired subse... March 1, 1913, then the profit or income to be returned is the difference ... cost and the selling price.

...sale of capital assets acquired prior to March 1, 1913, state—

...original cost of assets ..... $

...fair market price or value as of March 1, 1913 .....

...by which assets were sold .....

...fair market price or value as of March 1, 1913, was determined:

...

...

...income will include all payments received in cash or its ... or other property owned by the corporation making ... received.

...income includes all interest received on bonds or securi... with the exception of interest on obligations of a State ... or interest upon the obligations of the United States ... interest for the purpose of information should be ...

...AND OTHER CORPORATIONS.

| | Amount of principal. | Rate. | Amount of interest received. |
|---|---|---|---|
| | $ | | $ |
| | | | |
| | $ | | $ |

...to be made by a corporation out of its earnings ... cash or stock of the paying com... ...on account of income of the year in which ... to be returned. Stock dividends must be returned ... such stock value is held to be the proportionate ... paying corporation since March 1, 1913, as is ... or ordered to be distributed to the receiving ...

...which income has been received, and the amount thereof.

| | | | |
|---|---|---|---|
| ...Foreclosure | $ | 2 | 760 |
| ...Taxes | | | 50 |
| | $ | | |

...include only the ordinary and necessary expenses paid within the ... and operation of the business and properties of the corpora... ...salaries, and will not include any disbursements the ... specifically provided for in the return form proper on the obverse ...

...wholly secured by property collateral the subject of ... the ordinary business of the corporation as a dealer only in ... ...obtained or in the loaning of funds thereby produced, ... as a business expense to an amount of the interest paid on ... ...in excess of the actual value of the collateral securing it.

...material, labor, fuel, and other items entering into the cost of ... ...or investment are deductible under this head as expense, ... have not been considered in determining the cost or purchase ... ...derived from operations is ascertained through an ... ...as per Item 3 (a) of this statement.

...for incidental repairs which do not add to the value or appreciably ... ...of property are deductible as expenses, but expenditures for new ... improvements or betterments which increase the value of prop... ...replacing property, are not deductible under this or any other ... ...Such expenditures are properly chargeable to capital account, to ... through annual depreciation allowances.

...made to officers or employees who are stockholders, which payments are ... ...salaries or compensation and the amount of which is based upon ... ...such officers or employees, are not deductible as a business ...

| | | |
|---|---|---|
| (a) 1. Labor, wages, commissions, etc | $ | 23,400 |
| 2. Fuel, light, power, etc | | 19,333 |
| 3. Rentals (ordinary) | | 1,340 |
| 4. Repairs, ordinary and incidental | | 12,340 |
| 5. Interest on indebtedness wholly secured by collateral the subject of sale, etc | | 600 |
| 6. Salaries of officers | | 5,760 |
| 7. Other expenditures—Classify | | |
| | | |
| | | |
| | | |
| | | |
| Total expenses | | |

4. (a) 1. Names of officers and employees to whom salaries of $5,000 or more were paid during the year and amount paid to each. (If the space below is not adequate, a list marked "Item 4 (a)" containing this information should be attached to this form.)

| Name. | Address. | Amount. |
|---|---|---|
| | | |
| | | |
| | | |
| Total | | |

Total ..... $

When were the deducted losses ascertained to be such? ...

How were they so ascertained? ...

In case of losses resulting from the sale of capital assets acquired prior to March 1, 1913, state—

(1) Original cost of assets ..... $

(2) Fair market price or value as of March 1, 1913 .....

(3) Loss resulting from such sale .....

State also how the fair market price or value as of March 1, 1913, was ascertained:

...

...

(b) DEPRECIATION:

The amount deductible on account of depreciation is an amount charged off which fairly measures the loss during the year in the value of physical property by reason of exhaustion, wear and tear. Such amount should be determined upon the basis of the cost of the property and the probable number of years constituting its life. Stocks, bonds, and like securities, as well as any other intangible assets, are not subject to exhaustion, wear and tear within the meaning of the law. Hence any amount charged off as representing a shrinkage in the value of such assets is not deductible either as depreciation or loss.

Depreciation computed on total invoice value of merchandise in stock is not an allowable deduction, since any loss due to the shrinkage in the salable value of the merchandise will be reflected in the sales when the merchandise is disposed of.

| Kind of property. | Its cost. | Probable life after acquirement. | Amount of depreciation. This year. | Amount of depreciation. Previous years. |
|---|---|---|---|---|
| ... | ... | ... | $ | $ |
| ... | ... | ... | | |
| ... | ... | ... | | |
| Totals | | | | |

If buildings, state kind of construction.

(c) DEPLETION:

Depletion applies to the exhaustion of natural deposits, and contemplates a deduction to return to the corporation the capital invested, or in case of purchase prior to March 1, 1913, an amount sufficient to return to the corporation the fair market value of such deposits as of that date. An allowable deduction on account of depletion must not exceed the fair market value in the mine of the product thereof mined and sold during the year, and in case of oil or gas wells the amount deductible should be computed upon the basis of the decline in the settled flow. The amount sought to be deducted on this account must be charged off on the books of the company.

| *Kind of property. | Its cost if acquired subsequent to March 1, 1913. | †Fair market value as of March 1, 1913. | Amount of depletion. This year. | Amount of depletion. All years to date. |
|---|---|---|---|---|
| Coal | $ | $ | $ | $ |
| | | | | |
| | | | | |
| | | | | |

*Coal, iron ore, copper, oil, or gas.
†State how fair market value as of March 1, 1913, was determined.

...

6. (a) INTEREST DEDUCTIBLE:

The amount of interest deductible under this item is the amount actually paid within the year on an amount of bonded or other indebtedness not in excess of the paid-up capital stock outstanding at the close of the year, or if no capital stock, the entire amount of capital (not including interest-bearing indebtedness) employed in the business at the close of the year, plus, in each case, one-half of the interest-bearing indebtedness also then outstanding.

Capital employed in the business, as here used, contemplates the entire capital paid in by the members of the company, including so much of the accumulated surplus as is not in excess of the needs of the business, but does not include any borrowed capital or interest-bearing indebtedness.

Interest, so-called, or dividends paid upon preferred capital stock, is not deductible.

Interest deductible under this item includes all interest actually paid within the year not in excess of the limit hereinbefore indicated on any debt for which the corporation or any property in which it has title, interest, or equity is pledged, except interest on indebtedness wholly secured by collateral the subject of sale or hypothecation in the ordinary business of the company, etc., which interest is deductible under Item 4 (5) as a business expense.

INTEREST PAYMENTS ACTUALLY MADE DURING YEAR.

All forms of indebtedness upon which interest was paid should be listed here.

| Name or kind of obligation. | Amount of principal. | Rate of interest. | Amount of interest paid. |
|---|---|---|---|
| ... | $ | | $ |
| ... | | | |
| ... | | | |
| ... | | | |
| Total | $ | | $ |

(b) INTEREST PAID ON DEPOSITS.

Interest paid (by banks) on deposits or on money received for investment and secured by interest-bearing certificates of indebtedness issued by a bank, banking association, loan or trust company is deductible in the entire amount so paid.

7. (a) TAXES—FEDERAL, STATE, ETC. ..... $

(b) TAXES—FOREIGN .....

Taxes deductible under these items are such taxes as are imposed by the United States, by any State or Territory, or by any political subdivision thereof, or by the government of any foreign country, and are actually paid or accrued on the books of the corporation, not in excess of the amount due and payable within the year for which the return is made, except that taxes imposed under the laws of a foreign government are not deductible from the income arising and accruing to a foreign corporation by reason of the business transacted or capital invested in this country or (except that taxes paid for local benefits or taxes paid by corporations pursuant to covenants guaranteeing to the holders of tax free, are not deductible).

Taxes paid by banks or other corporations on the value of their capital stock outstanding and in the hands of stockholders are not deductible. Such taxes are a primary liability of the stockholders, as such, and are payable out of their income.

State whether or not this return is made on the basis of actual receipts and disbursements.

If not, describe fully the other method used in computing net income ...

Where sufficient space is not provided for the entry of the information required in the "Supplementary Statement," lists containing full information in the form indicated should be marked in accordance with particular item and attached to this form.

[141] Telephone Garfield 101

NORTH AMERICAN OIL CONSOLIDATED
Flatiron Building—Market at Sutter

San Francisco, California,
March 23, 1918.

Justus S. Wardell, Esq.,
Collector of Internal Revenue,
First District of California,
San Francisco, Cal.

Dear Sir:—

North American Oil Consolidated, a domestic corporation, herewith presents an amended Income Tax return for the year ending December 31, 1916. By comparing this amended return with the original return it will be shown that the net loss for the year 1916 is decreased from $129,434.42 to $27,593.14, which indicates an additional net income to the corporation of $101,841.28. The reason this additional income was omitted from the original return filed is as follows:

A portion of the property owned by the corporation consists of Section 2, Township 32 S., Range 23 M. D. B & M., situated in the Midway Oil District in Kern County, Cal. The title to this property has been in dispute with the United States Government, the Government claiming that it—and not the corporation—was the owner of the property. Returns from this property were received by the corporation up to and including the month of January, 1916, when a receiver was appointed in a suit that had been filed by the United

States Government against the corporation, affecting the title to this property. The income and expenses for the property for the month of January, 1916, were included in the original return. For the eleven remaining months of the year 1916 the property was not in possession of the corporation but was in the possession of the receiver, who operated the property and took into his own possession all the receipts therefrom, out of which he paid the operating expenses. The corporation, however, kept its books of accounts in the same manner in which it had previously kept them, showing the receipts from the property and the profits realized therefrom, and carrying these profits on its books and annual statement. As the profits, however, did not reach the corporation but were withheld by the receiver, it was not thought, at the time the original return was made, that the income tax should be paid on these profits unless they were finally actually received by the corporation, as it might have happened that the suit would have been decided against the corporation and in favor of the Government, in which event the corporation never would have received this money. The event, however, proved otherwise. The United States District Court decided, in 1917, that the corporation owned the property and that the United States Government had no claim thereto. Thereafter, and in due course, the money in the hands of the receiver was turned over to the corporation and actu-

[142] North American Oil Consolidated.
Justus S. Wardell, Esq.—#2 3/23/18.

ally received by it in cash. This money was received on the 3rd day of November, 1917. The net profit that accrued to the corporation during the year 1916, from this money in the hands of the receiver, was the amount of the difference between the loss shown by this amended return and the original return—i. e., $191,841.28

We, therefore, submit this amended return and ask that it be substituted for the original return rendered in February of 1917.

Very truly yours,
NORTH AMERICAN OIL CONSOLIDATED.

By LOUIS TITUS,
President.

By C. F. NANCE,
Secretary.

CFN–FR.

3851

CAUTION

Read this form and all instructions carefully and fill in supplementary statement on back of return first.

Totals in supplementary statement must agree with totals on face of return.

Form 1041 (Revised January 1917) UNITED STATES INTERNAL REVENUE

# CORPORATION INCOME TAX RETURN

(FOR ALL CORPORATIONS EXCEPT RAILROAD AND INSURANCE COMPANIES.)

Return of annual net income for the { calendar year 1917 / fiscal year ended DEC 31 1917

(Do not write in this space.)
RECEIVED
MAR 27 1918
MAR 3072 70
Audited by

Name of corporation [illegible]

Principal office [illegible]

Kind of business carried on [illegible] Date of organization [illegible]

1. Total amount of paid-up capital stock outstanding at the ... is no capital stock the capital other than interest-bear... the business at the close of the year. Unissued or ... cluded in this item, but only stock actually issued ... the year for which this return is made ... or if there ... employed in ... st not be in... t the close of

| | |
|---|---|
| (a) Paid-up "common stock" | $ |
| (b) Paid-up "preferred stock" | |
| Total paid-up stock | $ |
| or (c) Capital employed in business | $ |

2. Total amount of bonded or other interest-bearing indebt... of the year, exclusive of indebtedness wholly secur... sale or hypothecation in the ordinary business of th... of indebtedness incurred in the purchase of securities ... subject to income tax. ... g at the close ... be subject of ... exclusive also ... on which is not

| Character of obligation. | Rate of interest. | |
|---|---|---|
| 1st Mtg Bond Bonds | 6% | $ |
| | | |
| Total indebtedness | | $ |

INCOME.

| | | |
|---|---|---|
| 3. (a) Gross sales and other income from operations | | |
| (b) Income from rentals, royalties, etc | | |
| (c) Income from interest (see item 2c on back of return) | | |
| (d) Income from dividends (see item 3d on back of return) | | |
| (e) Income from all other sources (see item 3e on back) | | |
| Total gross sales and other income | | |
| Less total deductions | | |
| 8. Total net income | | |
| Total (a plus b) | | |
| Tax at 8% (Item 9 less total of a plus b) | | |
| Amount taxable at 12% (Item 10) | | |
| Total net income shown in Item 8 | | |
| (a) Dividends received (Item 3d) $ None | | |
| Total (a plus b) | | |
| Tax at 4% (Item 12 less total of a plus b) | | |

4. (a) Cost of goods and other property sold
(b) Expenses, [illegible]
5. (a) Losses sustained ... charged off
(b) Depreciation charged off
(c) Depletion charged off
6. (a) Interest paid (except as covered under (b) and (c))
(b) Interest paid on deposits (for banks only)
(c) Interest paid on indebtedness wholly secured by collateral
7. (a) Domestic taxes paid, not including income and excess profits taxes
(b) Foreign taxes paid
Total deductions

12. Amount of excess profits tax (see instructions below)
13. Amount of 2% tax (2% of Item 8)
14. Amount of 4% tax (4% of Item 12)
15. Amount of 8% tax (8% of [illegible])
16. Total tax assessable

REVIEWED
NOV 2 1920
REVIEWER

AUDITED
TAX LIABILITY

I, the undersigned, president and treasurer of the above-named company, which [illegible] net income is herein set forth, being ... and in the supplementary statement and in any ... hereto attached to or accompanying this return are, to his best knowledge and belief, [illegible] correct in each and every particular.

Sworn to and subscribed before me this 26th day of March, 1918

W. T. Brown.
NOTARY PUBLIC
In and for the City and County of San Francisco, State of California
(Official capacity.)

Seal of officer taking affidavit.

FOR
CLAIM CONTROL
NUMBER
BASIS (Value) Original
AUDITED BY
UNIT NO.
DATE 1918

GENERAL INSTRUCTIONS.

Excess profits tax.—For the purpose of war excess profits tax, every corporation subject to income tax shall be deemed to be engaged in business, and all the trades and businesses in which it is engaged (whether continuously carried on or not) shall be treated as a single trade or business, and all its income from whatever source derived shall be deemed to be received from such trade or business.

In the case of a trade or business having no invested capital or not more than a nominal capital, the excess profits tax is equivalent to 8 per cent of the net income in excess of $5,000. This tax applies primarily to corporations engaged principally in rendering personal service in which the employment of capital is not necessary and the earnings of which are to be credited primarily to the activities of the owners.

In the case of a trade or business having more than a nominal invested capital, the excess profits tax is equal to various percentages of the net income, depending on its ratio to the invested capital. Every corporation having a net income of over $5,000 for the taxable year must make a return of invested capital and compute the amount of tax on Form 1088.

For further instructions see Regulations No. 41, Relative to the War Excess Profits Tax. A copy can be obtained from any collector of internal revenue.

Time of filing returns.—Returns made on the basis of a calendar year must be filed on or before March 1 with the collector of internal revenue of the district in which is located the principal place of business of the corporation; if made on the basis of a FISCAL YEAR, they must be filed within 60 days after the close of such year.

Fiscal year.—Corporations desiring to make returns of annual net income on the basis of a fiscal year other than the calendar year must, not less than 30 days prior to March 1 of the ... excess profits tax law if made on the calendar year basis, file with the collector a notice in writing designating the last day of some month as the close of such fiscal year. ... with the date designated as the close of the fiscal year must be filed on or before the first day of March of the next calendar year.

1. Total amount of paid-up capital stock outstanding at the close of the year. If there is no capital stock the capital other than interest-bearing indebtedness employed in the business at the close of the year. Unissued or unsubscribed stock should not be included in this item, but only stock actually issued during the year for which this return is made

| | |
|---|---|
| (a) Paid-up "common stock" | |
| (b) Paid-up "preferred stock" | |
| Total paid-up stock | |
| or (c) Capital employed in business | |

2. Total amount of bonded or other interest-bearing indebtedness outstanding at the close of the year, exclusive of indebtedness wholly secured by collateral deposited with the lender or hypothecation in the ordinary business of the borrower. If any portion of the indebtedness is not subject to income tax, exclusive also of indebtedness incurred in the purchase of securities on which is not subject to income tax.

| Character of obligation. | Rate of interest. | Principal. |
|---|---|---|
| 1st Mtg Lease Bonds | 6% | $ 275 000 00 |
| | | |
| Total indebtedness | | $ 275 000 00 |

REVIEWED
(Examine all items on back of return.)
NOV 2 1922
REVIEWER

## INCOME.

| | | |
|---|---|---|
| 3. (a) Gross sales and other income from operations | $ 1186 41 | |
| (b) Receipts from rentals, royalties, etc | 2 815 50 | |
| (c) Receipts from interest (see item 3c on back of return) | 11 945 82 | |
| (d) Income from dividends (see item 3d on back of return) | None | |
| (e) Income from all other sources (see item 3e on back) | 68 040 06 | |
| Total gross sales and other income | $ 82 947 99 | |
| Less total deductions | 39 247 25 | |
| 8. Total net income | $ 43 700 74 | |
| Less (a) Excess profits tax (item 12) | $ 877 90 | |
| (b) Dividends received out of earnings of 1913, 1914, 1915 | None | |
| Total (a plus b) | | $ 877 90 |
| Balance taxable at 2% (item 8 less total of a plus b) | $ 42 822 84 | |
| (a) Amount taxable at 1% (item 8b) | | |
| Balance of total net income shown in item 8 | $ 42 822 84 | |
| Balance taxable at 4% (item 12 less total of a plus b) | $ 877 90 | |
| (b) Dividends received (item 3d) | None | |
| Total (a plus b) | | $ 877 90 |
| Balance taxable at 4% (item 10 less total of a plus b) | $ 41 944 94 | |
| If return is made for a fiscal year ended in 1917, amount at 4% on such fraction of item 11 as there is income from January 1, 1917, to the close of the fiscal year covered by this return | | |
| Total income taxable here | | |

| | | |
|---|---|---|
| 4. (a) Cost of goods and other property sold | | |
| (b) Expenses, [illegible] | | |
| 5. (a) Losses sustained [illegible] | | |
| (b) Depreciation other than [illegible] | | 19777 |
| (c) Depletion [illegible] | | |
| 6. (a) Interest paid (except as entered under 6b and c) | | 25877 |
| (b) Interest paid on deposits (for banks only) | | |
| (c) Interest paid on indebtedness wholly secured by collateral | | |
| 7. (a) Domestic taxes paid, not including income and excess profits taxes | | |
| (b) Foreign taxes paid | | |
| Total deductions | | $ 39 247 25 |
| 12. Amount of excess profits tax (see instructions below) | | $ 877 90 |
| 13. Amount of 2% tax (2% of item 8) | | |
| 14. Amount of 1% tax (1% of item 8b) | | |
| 15. Amount of 4% tax (4% of [illegible]) | | |
| 16. Total tax assessable | | |

AUDITED
TAX LIABILITY
FOR
CLAIM CONTROL
NUMBER
BASIS (P.) (T.) OF
AUDITED BY
CHIT NO.
DATE 1922

I, the undersigned, president and treasurer of the above-named company, whose total net income is herein set forth, being duly sworn, each for himself, deposes and says that the items entered in the foregoing report and in the supplementary statement and in any schedule thereto attached or accompanying this return are, to his best knowledge and belief, true and correct in each and every particular.

Subscribed and sworn to before me this 26th day of March; 1918.

W. T. Brown.
NOTARY PUBLIC
In and for the City and County of San Francisco, State of California
(Official capacity.)

Seal of officer taking affidavit.

## GENERAL INSTRUCTIONS.

**Excess profits tax.**—For the purpose of war excess profits tax, every corporation subject to income tax shall be deemed to be engaged in business, and all the trades and businesses in which it is engaged (whether continuously carried on or not) shall be treated as a single trade or business, and all its income from whatever source derived shall be deemed to be received from such trade or business.

In the case of a trade or business having no invested capital or not more than a nominal capital, the excess profits tax is equivalent to 8 per cent of the net income in excess of $3,000. This tax applies primarily to corporations engaged principally in rendering personal service in which the employment of capital is not necessary and the earnings of which are to be ascribed primarily to the activities of the owners.

In the case of a trade or business having more than a nominal invested capital, the excess profits tax is equal to various percentages of the net income, depending on its ratio to the invested capital. Every corporation having a net income of over $3,000 for the taxable year must make a return of invested capital and compute the amount of tax on Form 1120.

For further instructions see Regulations No. 41, Relative to the War Excess Profits Tax. A copy can be obtained from any collector of internal revenue.

**Time of filing returns.**—Returns made on the basis of a calendar year must be filed on or before March 1 with the collector of internal revenue of the district in which is located the principal place of business of the corporation; if made on the basis of a FISCAL YEAR, they must be filed within 60 days after the close of such year.

**Fiscal year.**—Corporations desiring to make returns of annual net income on the basis of a fiscal year other than the calendar year must, not less than 30 days prior to March 1 of the year in which the return would be due if made on the calendar year basis, file with the collector a notice in writing designating the last day of some month as the close of such fiscal year. A return for that portion of the calendar year ending with the date designated as the close of the fiscal year must be filed on or before the first day of March of the next calendar year, and the return for each full fiscal year thereafter must be filed within 60 days after the closing date of the fiscal year as established.

**Extension of time.**—In the case of neglect to file the return within the prescribed time, the collector is authorized to grant an extension of the filing period not exceeding 30 days from the normal due date, provided such neglect was due to absence or sickness and provided an application for such extension is made in writing prior to the expiration of the period for which extension may be granted. In meritorious cases the Commissioner is authorized to grant such further extension as he may deem proper.

**Signatures and verification.** Returns must be signed and verified by two of the officers of the corporation, that is, by the president, vice president, or other principal officer, and the treasurer or other financial officer, and must be sworn to before an officer authorized to administer oaths, and the seal of the attesting officer, if he is required to have a seal, must be impressed on the return in the space provided for that purpose.

**Subsidiary companies.** The corporation making this return must attach hereto a list of all its subsidiary companies, if any, with the location of the principal place of business of each. Each subsidiary company must make a separate and distinct return.

**Foreign corporations.**—Foreign corporations subject to the law are required to make return to the collector in the district in which is located the principal place of business or agency through which it is transacted the business in the United States, or if the corporation has no place of business in the United States, the return will be filed with the collector of internal revenue at Baltimore, Maryland. The gross income to be returned includes the entire business transacted and capital invested in the United States, including interest on bonds, notes, or other interest bearing obligations of residents, corporations, partnerships, or associations, and dividends on stock of resident corporations, joint stock companies, or associations, but does not include income derived from sources without the United States. In computing net income there shall be allowed as deductions only such losses and disbursements incurred and necessary to the transaction of the business in this country, all as specifically set out in the Act. For certain taxes deductible in the case of citizens, the corresponding and accruing to a foreign corporation from business done or capital invested in the United States. If a foreign corporation has no place of business in the United States and no return is made, the tax on income from interest and dividends will be withheld at the source.

**Penalties.** Corporations refusing or neglecting to make returns within the time prescribed by law or rendering [illegible] shall be liable to a penalty of not exceeding $10,000, and an additional tax of 50 per cent because of neglect to file the return within the time prescribed by law, or 5 per cent in the case of a false or fraudulent return, shall be added to the assessment, provided that in case of delinquency it is shown that the failure was not for the purpose to evade tax and that the delinquency was due to reasonable cause and not to willful neglect, the 50 per cent addition shall not be made. Any officer of any corporation required by law to make [illegible] any statement with intent to defeat or evade the assessment required by law shall be guilty of a misdemeanor and shall be fined not exceeding $10,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

FOR AUDITOR'S USE ONLY

D-1

# SUPPLEMENTARY STATEMENT

**The following information must be furnished, either on this sheet or on attached schedules, by every corporation, joint-stock company, or association. Without such information the return will not be accepted as complete. The items below relate to the correspondingly numbered items on the first page.**

**3. (a) FROM INTEREST.**

Interest to be reported as income for the purpose of the income tax includes all interest received on bonds or securities owned by the corporation, except interest on obligations of a State or political subdivision thereof or interest upon the obligations of the United States or its possessions.

**3. (d) FROM DIVIDENDS RECEIVED.**

Any distribution made or ordered to be made by a corporation out of its earnings or profits accrued since March 1, 1913, whether in cash or stock of the paying company, must be returned (under Item 3 (d) on front page of this form) by the receiving corporation as income of the year in which the distribution was made or ordered to be made and will be taxed at the rates prescribed by law for the years in which surplus or profits distributed were earned, viz, 1% on amounts received out of earnings of 1913 (subsequent to March 1, 1913), 1914, and 1915, and 2% on amounts received from earnings of 1916 and 1917. A statement from the corporation paying the dividends included herein should be attached to this return, showing separately the amount of dividends paid out of earnings of each year; otherwise, they will be deemed to have been paid out of the earnings of 1917 and will be taxed 2%. The receiving corporation, in order that tax may be computed on dividends received in 1917 at the rates applicable to the years in which the profits were earned, must fill in the following form:

Dividends received in 1917 out of profits earned during year subsequent to March 1, 1913.

| 1913 | 1914 | 1915 | 1916 | 1917 | Total |
|---|---|---|---|---|---|
| $ | $ | $ | $ | $ | |

**3. (e) FROM OTHER SOURCES.**

Income received, from all sources not elsewhere specified, should be itemized below:

| | | | |
|---|---|---|---|
| Profit from sale of property | $ | [illegible] | [illegible] |
| Profit from settlement of [illegible] | | [illegible] | [illegible] |
| Profit from sale of Bonds | | [illegible] | [illegible] |
| Profit from sale of property in 1916 | | 33 | 682 51 |
| Total | $ | 65 | 040 06 |

**4. (a) COST OF GOODS AND OTHER PROPERTY SOLD.**

Report the cost of goods sold in the following form:

| | | | |
|---|---|---|---|
| Merchandise bought for sale | | | |
| Cost of manufacturing or otherwise producing goods (if separately kept, give details) | | | |
| Labor, (separate schedule showing principal items of cost) | | | |
| Raw materials at beginning of year | | | |
| Total | | | |
| Less inventories at end of year | | | |
| Net cost of goods sold | | | |
| Explanations | | | |

If the corporation makes inventories of merchandise or materials, explain the basis on which they are made, whether (a) at cost, or (b) at cost or market value, whichever is lower. If no inventories are made, make no entries referring to inventories, but report as cost of goods purchased or produced during the year. If the cost of manufacturing [illegible] below.

[illegible] property sold, report the cost of the property sold for the purpose of this return, as follows:

| | |
|---|---|
| 1. Original cost of property | $ |
| 2. Depreciation since March 1, 1913, if acquired before that date | |
| 3. Cost of subsequent improvements, if any | |
| 4. Depreciation and depletion to date of sale | |
| 5. Net cost (Item 1 or Item 2 plus Item 3 minus Item 4) | |
| 6. State how market value March 1, 1913, was determined | |

Does such value include any good will? If so, how much? $

**4. (b) EXPENSES, GENERAL.**

This item should include only the ordinary and necessary expenses paid within the year in the operation of the business and maintenance of the properties of the corporation, itemized as per schedule below. It must not include any expenditures reported under 4 (a), 5, 6, or 7.

Expenditures for incidental repairs which do not add to the value or appreciably prolong the life of property are deductible as expenses, but expenditures for new buildings, permanent improvements or betterments which increase the value of property, or for restoring or replacing property, are not deductible under this or any other item of the return. Such expenditures are properly chargeable to capital account, to be extinguished through annual depreciation charges.

Payments made to officers or employees, who are stockholders, in the guise of salaries or compensation, the amount of which is based upon the stockholdings of such officers or employees, are not deductible as a business expense.

| | | | |
|---|---|---|---|
| 1. Salaries of officers | $ | [illegible] | |
| 2. Labor, wages, compensation, etc. (not included in "Cost of manufacturing or otherwise producing goods" under 4 (a)) | | [illegible] | |
| 3. Rents, royalties, and other payments in lieu of rent | | [illegible] | |
| 4. Repairs, ordinary and incidental | | [illegible] | |
| [illegible] | | [illegible] | |
| [illegible] | | [illegible] | |
| 5. Other expenditures (classify) [illegible] | | [illegible] | |
| [illegible] | | [illegible] | |

When were the deducted losses ascertained to be such? [illegible]

How were they so ascertained? [illegible]

The cost of property lost should be determined as indicated in Item 4 (a).

A bad debt offsetting income accrued since January 1, 1909, will not be allowed as a deduction unless the amount was reported as income for the year in which the debt was created.

State how the debts charged off (if any) were ascertained to be worthless [illegible]

No debts charged off

If at any future time a debt charged off as worthless is collected the amount collected must be returned as income for the year in which received.

Unpaid debts are not deductible if made good by recovery of property sold or retention of property pledged.

**5. (b) DEPRECIATION.**

The amount deductible on account of depreciation is an amount charged off which fairly measures the loss during the year in the value of physical property by reason of exhaustion, wear, and tear. Such amount should be determined upon the basis of the cost of the property and the probable number of years constituting its life. Stocks, bonds, and like securities, as well as any other intangible assets, are not subject to exhaustion, wear, and tear within the meaning of the law. Hence any amount charged off as representing a shrinkage in the value of such assets is not deductible either as depreciation or as a loss.

Depreciation computed on total invoice value of merchandise in stock is not an allowable deduction by reason of damage or obsolescence the merchandise is unsalable.

If a deduction is made on account of depreciation, the following statement must be filled in:

| Kind of property | Its cost. | Probable life after acquirement. | Amount of depreciation charged off. This year. | Amount of depreciation charged off. Previous years. |
|---|---|---|---|---|
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Totals | [illegible] | | [illegible] | [illegible] |

If building, state under "Kind of property" the material of which constructed.

**5. (c) DEPLETION.**

Depletion applies to the exhaustion of natural deposits, and contemplates a deduction to return to the corporation the capital invested, or in case of purchase prior to March 1, 1913, an amount sufficient to return to the corporation the fair market price or value of such deposits as of that date. An allowable deduction on account of depletion must not exceed the fair market value as of March 1, 1913, or the cost subsequent to that date, of the product mined and sold during the year, and will be determined in accordance with the rule set out in Articles 170 to 178, Regulations 33, Revised. The amount sought to be deducted on this account must be charged off on the books of the company.

| *Kind of property. | Its cost if acquired subsequent to March 1, 1913. | †Fair market value as of March 1, 1913. | Amount of depletion charged off. This year. | Amount of depletion charged off. Previous years. |
|---|---|---|---|---|
| [illegible] | [illegible] | $ | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |

* State in a word, coppers, silver, or gold.

† State how fair market value as of March 1, 1913, was determined [illegible]

[illegible] written off to that date

**6. INTEREST PAID.**

(a) The amount of interest deductible under (c) is the amount actually paid within the year on an amount of bonded or other indebtedness (except an indebtedness falling under 6 (b) or 6 (c) and indebtedness incurred for the purchase of obligations or securities the income from which is exempt from income tax) not in excess of the paid-up capital stock outstanding at the close of the year, or if there is no capital stock, the entire amount of capital (not including interest-bearing indebtedness) employed in the business at the close of the year, plus, in each case, one-half of the interest-bearing indebtedness also then outstanding.

Capital employed in the business, as here used, contemplates the entire capital paid in by the members of the company, including so much of the accumulated surplus as is actually employed in the business, but does not include any borrowed capital or interest-bearing indebtedness.

(b) Interest paid (by banks) on deposits or on money received for investment and secured by interest-bearing certificates of indebtedness issued by a bank, banking association, or loan or trust company is deductible in the entire amount so paid.

(c) If the corporation's indebtedness, or any part thereof, is wholly secured by collateral which is the subject of sale or hypothecation in the corporation's ordinary business as a dealer in such property, the interest paid on an amount of such indebtedness not exceeding the actual value of the collateral may be deducted.

Describe all obligations on which interest is paid in the following form. Distinguish plainly collateral loans falling under 6 (c) and also obligations incurred for the purchase of securities, the income from which is exempt from income tax.

| Kind of obligation. | Amount of principal. | Rate of interest. | Amount of interest paid. |
|---|---|---|---|
| [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] |
| [illegible] | [illegible] | [illegible] | [illegible] |
| Total | [illegible] | | [illegible] |

**7. (a) TAXES PAID.**

Taxes, paid or accrued on the books of the corporation during the taxable year, are deductible with the following exceptions: Federal income and excess profits taxes (including taxes paid on the interest on its own obligations in pursuance of a covenant contained therein relieving the holder of liability for such taxes), foreign taxes on income derived from sources within the United States by foreign corporations, local taxes specially assessed against property on account of benefits derived from public improvements or betterments, and taxes upon the corporation's capital stock in the hands of the stockholders.

Dividends received in 1917 out of profits earned each year subsequent to March 1, 1913.

| 1913 | 1914 | 1915 | 1916 | 1917 |
|---|---|---|---|---|
| $ | $ | $ | $ | $ |

**2. (c) FROM OTHER SOURCES.**

Income received from all sources not elsewhere specified should be itemized below:

| | | |
|---|---|---|
| Interest on bank deposits and on bonds | $ | 11 111 47 |
| Gain from sale of bonds | | 400 — |
| Profit from settlement of claim | | 19 519 05 |
| Profit from sale of property in 1918 | | 33 582 51 |
| Total | $ | 65 040 03 |

**4. (a) COST OF GOODS AND OTHER PROPERTY SOLD.**

Report the cost of goods sold in the following form:

| | | |
|---|---|---|
| Merchandise bought for sale | | |
| Cost of manufacturing or otherwise producing goods (if separately shown on books, attach schedule showing principal items of cost) | | |
| Total | | |
| Less inventories at end of year | | |
| Net cost of goods sold | | |

Explanation: Cost of Sales at Plant, Warehouse & Yard

If the corporation makes inventories of merchandise or materials, explain the basis on which they are made, whether (a) at cost, or (b) at cost or market value, whichever is lower. If no inventories are made, make no entries referring to inventories, but report the total cost of goods purchased or produced during the year. If the cost of manufacturing includes any cost [illegible] expenses from general expenses in the corporation's books, enter it in "Expenses, general," below.

If the corporation has sold any of its capital assets, report the cost of the property sold in the following:

| | |
|---|---|
| 1. Kind of property | $ |
| 2. Cost if acquired before March 1, 1913, if acquired before that date | |
| 3. Cost of subsequent improvements, if any | |
| 4. Depreciation and depletion to date of sale | |
| 5. Net cost (item 1 or item 2 plus item 3 minus item 4) | |
| 6. State how market value March 1, 1913, was determined | |

Does such value include any good will? If so, how much? $

**4. (b) EXPENSES, GENERAL.**

This item should include only the ordinary and necessary expenses paid within the year in the operation of the business and maintenance of the properties of the corporation, itemized as per schedule below. It must not include any expenditures reported under 4 (a), 5, 6, or 7.

Expenditures for incidental repairs which do not add to the value or appreciably prolong the life of property are deductible as expenses, but expenditures for new buildings, permanent improvements or betterments which increase the value of property, or for restoring or replacing property, are not deductible under this or any other item of the return. Such expenditures are properly chargeable to capital account, to be extinguished through annual depreciation charges.

Payments made to officers or employees, who are stockholders, in the guise of salaries or compensation, the amount of which is based upon the stockholdings of such officers or employees, are not deductible as a business expense.

| | | | |
|---|---|---|---|
| 1. Salaries of officers | $ | 15 [illegible] | 11 |
| 2. Salaries, wages, commissions, etc. (not included in "Cost of manufacturing or otherwise producing goods" under 4 (a)) | | 9a [illegible] | 22 |
| 3. Rents, royalties, and other payments in lieu of rent | | 2 a.a5 | 99 |
| 4. Repairs, ordinary and incidental | | 11 15 ab | 11 |
| Fuel, Light, Power &c | | 8a [illegible] | 92 |
| Insurance Premiums | | [illegible] | 91 |
| 5. Other expenditures (classify) Main Office " | | [illegible] | 8 |
| Warehouse | | [illegible] | 12 |
| Total expenses | $ | 15[illegible] | 27 |

If salaries were increased or extra compensation was paid to officers, state the amount, the reason therefor, and the basis on which computed: Salaries increased to meet present conditions

**5. (a) LOSSES.**

Losses deductible under this item must be distinguished from depreciation or allowances for exhaustion, wear, and tear. The loss not compensated by insurance or otherwise, must be absolute, complete, actually sustained during the year, and charged off on the books of the corporation.

| Kind of property on which loss is claimed | Cost of property | Cause of loss | Amount charged off within year |
|---|---|---|---|
| Lack Knit Underwear | $ 2,215 00 | Explosion | 2,215 00 |
| Castor plant | 4 [illegible] | | |
| Total | | | |

like securities, as well as any other intangible assets, and not connected with and forming a part of the business, are capital assets within the meaning of the law. Hence any amount charged off as depreciation in the value of such assets is not deductible either as depreciation or as a loss.

Depreciation computed on total invoice value of merchandise in stock is not an allowable deduction by reason of damage or obsolescence the merchandise is unsalable.

If a deduction is made on account of depreciation, the following statement must be filled in:

| Kind of property | Its cost. | Probable life after acquirement. | Amount of depreciation charged off. This year. | Amount of depreciation charged off. Previous years. |
|---|---|---|---|---|
| Factory Buildings | $ 5,000.00 | 8 1/2 years | $ [illegible] | $ [illegible] |
| Machinery, Tools | 9,000.00 | " | 2,160.00 | 6,480.00 |
| Office Equipment | $18,275.47 | " | [illegible] | [illegible] |
| Total | $ [illegible] | | $ [illegible] | $ [illegible] |

If building, state under "Kind of property" the material of which constructed.

**5. (c) DEPLETION.**

Depletion applies to the exhaustion of natural deposits, and contemplates a deduction to return to the corporation the capital invested, or in case of purchase prior to March 1, 1913, an amount sufficient to return to the corporation the fair market price or value of such deposits as of that date. An allowable deduction on account of depletion must not exceed the fair market value as of March 1, 1913, or the cost subsequent to that date, of the product mined and sold during the year, and will be determined in accordance with the rule set out in Articles 170 to 178, Regulations 33, Revised. The amount sought to be deducted on this account must be charged off on the books of the company.

| *Kind of property. | Its cost if acquired subsequent to March 1, 1913. | †Fair market value as of March 1, 1913. | Amount of depletion charged off. This year. | Amount of depletion charged off. Previous years. |
|---|---|---|---|---|
| Coal Property | Prospect | $ — | $ [illegible] | [illegible] |
| " | " | [illegible] | [illegible] | [illegible] |
| " | " | [illegible] | [illegible] | [illegible] |

* State here if ores, coals, oil or gas.

† State how fair market value as of March 1, 1913, was determined: Cost of property less amount of depletion written off to that date

**6. INTEREST PAID.**

(a) The amount of interest deductible under (c) is the amount actually paid within the year on an amount of bonded or other indebtedness (except on indebtedness falling under 6 (b) or 6 (c) and indebtedness incurred for the purchase of obligations or securities the income from which is exempt from income tax) not in excess of the paid-up capital stock outstanding at the close of the year, or if there is no capital stock, the entire amount of capital (not including interest-bearing indebtedness) employed in the business at the close of the year, plus, in each case, one-half of the interest-bearing indebtedness also then outstanding.

Capital employed in the business, as here used, contemplates the entire capital paid in by the members of the company, including so much of the accumulated surplus as is actually employed in the business, but does not include any borrowed capital or interest-bearing indebtedness.

(b) Interest paid (by banks) on deposits or on money received for investment and secured by interest-bearing certificates of indebtedness issued by a bank, banking association, or loan or trust company is deductible in the entire amount so paid.

(c) If the corporation's indebtedness, or any part thereof, is wholly secured by collateral which is the subject of sale or hypothecation in the corporation's ordinary business as a dealer in such property, the interest paid on an amount of such indebtedness not exceeding the actual value of the collateral may be deducted.

Describe all obligations on which interest is paid in the following form. Distinguish plainly collateral loans falling under 6 (c) and also obligations incurred for the purchase of securities, the income from which is exempt from income tax.

| Kind of obligation. | Amount of principal. | Rate of interest. | Amount of interest paid. |
|---|---|---|---|
| Secured debt | $ [illegible] | [illegible] | $ [illegible] |
| Promissory Notes | [illegible] | [illegible] | [illegible] |
| Account " | [illegible] | [illegible] | [illegible] |
| Total | $ [illegible] | | $ [illegible] |

**7. (a) TAXES PAID.**

Taxes, paid or accrued on the books of the corporation during the taxable year, are deductible with the following exceptions: Federal income and excess profits taxes (including taxes paid on the interest on its own obligations in pursuance of a covenant contained therein relieving the holder of liability for such taxes), foreign taxes on income derived from sources within the United States by foreign corporations, local taxes specially assessed against property on account of benefits derived from public improvements or betterments, and taxes upon the corporation's capital stock in the hands of the stockholders.

**BASIS OF RETURN.**

Is this return made on the basis of actual receipts and disbursements? Yes

If not, describe fully what other basis or method was used in computing net income

**UNDISTRIBUTED INCOME, SURPLUS, AND UNDIVIDED PROFITS.**

| | |
|---|---|
| Total net income of taxable year preceding that for which this return is made (less income tax paid thereon) | $ [illegible] |
| Amount of such income remaining undistributed six months after the close of that year | None |
| Amount of such income remaining undistributed twelve months after the close of that year | None |
| Total surplus and undivided profits at close of taxable year | $ 1,524,724.16 |

If sufficient space is not provided for the entry of any information required in the "Supplementary Statement," schedules in the form indicated, marked with the number of the item to be explained, should be attached to this form.

Now, November 6, 1930, the foregoing statement of evidence certified from the record as a true copy.

[illegible]
Clerk, U. S. Board of Tax Appeals.

[145] Filed Oct. 11, 1930. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET Nos. 8714–16,107.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

NORTH AMERICAN OIL CONSOLIDATED,
Respondent.

PRAECIPE FOR TRANSCRIPT OF RECORD.

To the Clerk of the United States Board of Tax Appeals:

Please prepare a transcript of record in this cause, on or before November 10, 1930, transmit the same to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, and include in said transcript copies, duly certified as correct, of the following documents:

1. The docket entries of proceedings before the Board in the above-entitled cause;
2. All pleadings;
3. Findings of fact and opinion of the Board;
4. Final order of redetermination entered on August 29, 1929;
5. Petition for review;
6. Any and all orders of enlargements made by the Board with respect to preparation of record on appeal;
7. Statement of evidence, together with the ex-

hibits thereto attached and the order of the Board approving and settling the same;

8. This praecipe for transcript.

[146] Said transcript to be prepared, certified and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Ninth Circuit.

Dated October 11, 1930.

G. A. YOUNGQUIST.
G. A. YOUNGQUIST,
Assistant Attorney General.
(Signed) C. M. CHAREST.
C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

11d.
10/10/30.

Now, November 6, 1930, the foregoing praecipe certified from the record as a true copy.

[Seal] B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

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[Endorsed]: No. 6315. United States Circuit Court of Appeals for the Ninth Circuit. David Burnet, Commissioner of Internal Revenue, Petitioner, vs. North American Oil Consolidated, a Corporation, Respondent. Transcript of Record. Upon Petition to Review an Order of the United State, Board of Tax Appeals.

Filed November 19, 1930.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

No. 6315

# United States
# Circuit Court of Appeals
## For the Ninth Circuit.

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DAVID BURNET, Commissioner of Internal Revenue,

Petitioner,

vs.

NORTH AMERICAN OIL CONSOLIDATED, a Corporation,

Respondent.

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**Upon Petition to Review an Order of the United States Board of Tax Appeals.**

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**PROCEEDINGS HAD IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.**

At a stated term, to wit, the October term, A. D. 1930, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the courtroom thereof, in the City and County of San Francisco, in the State of California, on Monday, the eighth day of June, in the year of our Lord one thousand nine hundred and thirty-one. Present: The Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding; Honorable WILLIAM H. SAWTELLE, Circuit Judge; Honorable JEREMIAH NETERER, District Judge.

[Title of Cause.]

ORDER OF SUBMISSION.

ORDERED above cause argued by Mr. Allin H. Pierce, Special Attorney, Bureau of Internal Revenue, counsel for the petitioner, and by Mr. Herbert W. Clark, counsel for the respondent, and submitted to the Court for consideration and decision.

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At a stated term, to wit, the October term, A. D. 1930, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the courtroom thereof, in the City and County of San Francisco, in the State of California, on Monday, the fifteenth day of June, in the year of our Lord one thousand nine hundred and

thirty-one. Present: The Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding; Honorable WILLIAM H. SAWTELLE, Circuit Judge; Honorable JEREMIAH NETERER, District Judge.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT.

By direction of the Court, ORDERED that the typewritten opinion this day rendered by this court in above cause be forthwith filed by the Clerk and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion filed.

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[Title of Court and Cause.]

OPINION U. S. CIRCUIT COURT OF APPEALS.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges, and NETERER, District Judge.

WILBUR, Circuit Judge.—Petitioner seeks to review a decision of the Board of Tax Appeals with relation to a deficiency tax of respondent for income and profit taxes for the year 1917. The sole

question involved is whether or not the sum of $171,972.20 derived from the sale of oil produced on section 2 during the year 1916 impounded in the hands of a receiver appointed by the federal court for that purpose and retained by him until 1917 under order of court, turned over to the respondent, was taxable as income for the year 1917. The land which produced this oil was government land which had been in the possession of the respondent under placer mining claims. The government contended that as the land had been withdrawn from location by an order of President Taft the respondent was not entitled to a patent. An action was brought to terminate the respondent's right and in that action the receiver was appointed. The respondent was a large operating company holding many pieces of property and this litigation affected only the property in section 2. The trial court determined the matter in favor of the respondent (U. S. vs. No. Am. Oil Co., 242 Fed. 723). This decision was affirmed by the Circuit Court of Appeals of this circuit (264 Fed. 336). The case was finally disposed of by the Supreme Court of March 21, 1920, when it issued its mandate dismissing the appeal thereto in pursuance of a stipulation of counsel. The money thus impounded had been paid over to the respondent after the decision of the district court in 1917.

The Board of Tax Appeals held, in accordance with the contention of the respondent, that the income impounded by the receiver should have been returned by him as his income for the year 1916.

In that regard we quote from the opinion of the Board of Tax Appeals as follows:

> "The respondent affirmatively alleges that the amount impounded in the hands of the receiver in 1916 and released to petitioner in 1917 was income to the petitioner in the latter year. The respondent's principal argument in support of his claim herein is that petitioner was on the cash receipts and disbursements basis in the years 1916 to 1919, inclusive, and, as the amount here involved was not actually received by the petitioner until 1917 it must be taxable income in that year. We think it immaterial whether petitioner's accounts were kept on the receipts and disbursements basis or some other basis as permitted by section 13(d) of the Revenue Act of 1916. The fact is that the income was actually produced in 1916. The sole reason that it did not reach the petitioner in that year was because of the suit by the United States. By reason of that suit a receiver was appointed, who actually received the income, and who should have reported it for taxation. Section 13(c) of the Revenue Act of 1916; United States vs. Chicago & E. I. Ry. Co., 298 Fed. 779; Forstmann vs. Ferguson, 17 Fed. (2d) 659, affirmed, 25 Fed. (2d) 47. If the receiver did not report it, that is no sufficient reason for taxing the petitioner on it in a later year. Accordingly, the amount of $171,979.22 received by petitioner in 1917 is not an item of income in that year."

The petition contends that section 12, subdivision c, of the Revenue Act of 1916, 39 Stats. 756, does not apply, for the reason that it is inapplicable to a receiver holding only a part of the property of the taxpayer corporation. This section provides for returns by receivers where they are operating "the property of business of corporations," etc. It is provided that they "shall make returns of net income as and for such corporations, * * * in the same manner and form as such organizations are hereinbefore required to make returns." It provides that the tax should be assessed in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody or control. It will be observed that as applied to the receiver having possession of the entire property of the corporation, etc., as in the case of receiver in bankruptcy, the statutory provisions with reference to such taxation are readily applicable, but where only a portion of the property of the corporation is in the hands of a receiver it would follow that only a portion of the income of the corporation was in the possession of the receiver and the tax could not be assessed and collected in the same manner as if assessed directly against the taxpayer, unless for purposes of assessment and collection it was in some fashion combined with the income, if any, received directly by the corporation or in case of loss by the corporation and corresponding deduction was made therefrom. While this consideration does not necessarily determine the proper interpretation of the statute (sec. 13[c]

*supra*) it clearly points to the conclusion that section 13(c) applies only to receivers who are operating the entire property or business of a corporation, etc. The Secretary of the Treasury, soon after the enactment of the statute in 1916, adopted regulations based upon that view of the statute (art. 26, par. 181, art. 209). We quote therefrom as follows:

> " * * * such receiver, trustee, or assignee stands in the place of the corporate officers and is required for the purpose of this title to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. The income which he receives on account of the business transacted is the income of the corporation and, no matter how such income is applied, it is subject to the tax imposed by this title insofar as it exceeds the deductions or allowances authorized by law."

Later additional regulations were promulgated pursuant to 40 Stats. 1057, 1058:

> "A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. * * * A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to

render returns of income. In general, statutory receivers and common-law receivers of all the property of business of an individual or corporation must make returns."

Article 622, after providing for returns of income by receivers, concludes as follows:

"A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. See articles 424 and 547."

Similar provisions were incorporated in the regulations promulgated under later statutes. If in any case it is proper for a receiver to withhold a return of income on the ground that the property in his custody does not constitute all of the property of the taxpayer, it is clear that where the receiver is appointed because of a controversy over the title to the property which he holds which is only a part of that owned by the taxpayer, it is preeminently a case in which the return should not be made by the receiver who has been appointed for the very purpose of impounding the income to await the determination of the court as to its ownership. If it is to be treated as a part of the income of the owner of the property, the amount of tax thereon would depend upon which one of the two litigants was subsequently determined to be the owner, and this difficulty is particularly marked in the situation presented by the case at bar, where if the income belonged to the government it was not sub-

ject to tax, whereas, if it belonged to the respondent the amount of tax thereon would depend upon the income derived by the respondent taxpayer.

We are informed by the brief filed on behalf of the government that the uniform practice of the Treasury Department with relation to returns from receiverships has been in accordance with the rules of the Treasury Department as above interpreted and that under that practice the receiver of a part only of respondent's property as in the case at bar was neither required nor permitted to make such return.

In view of the departmental construction placed upon the statute, which seems to be in accordance with the intent of Congress, the receiver was not required to make return of this income, but the respondent corporation was required to do so.

It remains to consider whether or not the respondent, who was entitled to the income derived from its property which was impounded by the receiver, was liable for income tax thereon as a part of its income for the year 1917. This depends, in our view, as is contended by the respondent, upon the method adopted by the taxpayer for keeping its books and making its returns. When the receipts were derived from the sale of the land, they belonged to the taxpayer, but were not payable to it until such time as the court ordered its property turned over to it. It is admitted that the taxpayer made its income tax returns upon the cash basis. It thus elected, as it had a right to do, to defer payment of the tax upon its income until it had actually

received the income in cash. It did not receive the income in cash, nor was it entitled so to do until the money was paid over to it by the receiver. In this connection it should be remembered that the returns are made and taxes assessed during the current fiscal year, and while the commissioner has power to levy a tax later if the taxpayer has not made proper returns of its income, this provision is for the protection of the government and not for the protection of the taxpayer. In these numerous cases where a large part of the revenue of oil companies operating upon government land was impounded by receivers in litigation instituted by the government, it would obviously work a great hardship upon the oil companies if a tax were levied upon the entire receipts and they were required to pay the entire tax without having received the income. It is true that this difficulty would be met by the receiver making a return and paying the tax from the income in his hands, but, as we have shown, the receiver was neither required nor permitted to do so in the case at bar, and the question we are considering is that of the duty of the taxpayer in making his income tax return where he has adopted the cash return method. We think it clear that the taxpayer was entitled in such a case to postpone a return of his income until it was received by him, and therefore, that it was taxable as income for the year 1917. The decision of Burnet vs. Sanford & Brooks, 282 U. S. 359, supports the view that we have advanced. In that case Sanford & Brooks were engaged in dredging for the

government. In 1915 they declined to proceed with the work and brought suit against the government for the amount expended in performance of the contract on the ground that the government had failed to make proper disclosure of the character of the dredging to be done. The Court of Claims awarded a judgment against the government in 1918. This judgment was affirmed by the Supreme Court in 1920 (U. S. vs. Atlantic Dredging Co., 253 U. S. 1), and the judgment was paid by the government in 1920. It was contended by the taxpayer that it was entitled to make return of this amount as income for the years 1913–14–15–16, during which the work was done and money expended, with the result that such expenditures made during those years would offset the income. The Supreme Court held that the income was properly taxable as income for the year 1920, there being no evidence that the taxpayer took advantage of the regulation providing for reporting income on long-term contract basis under treasury regulations, or upon an accrual basis under section 212(b).

Income is ordinarily taxable only when it is received. See, also, decision in Herold vs. Mutual Benefit Life Ins. Co., 201 Fed. 918; Maryland Casualty Co. vs. U. S., 251 U. S. 342; Eisner vs. Macomber, 252 U. S. 189, 207; Eckert vs. Burnet, decided April 13, 1931; Lucas, Commissioner, vs. No. Texas Oil Co., 281 U. S. 11; Commissioner vs. Garber, No. 6219 (C. C. A. 9), decided June 8, 1931.

Order reversed.

[Endorsed]: Opinion. Filed June 15, 1931. Paul P. O'Brien, Clerk.

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United States Circuit Court of Appeals for the Ninth Circuit.

No. 6315.

DAVID BURNET, Commissioner of Internal Revenue,

Petitioner,

vs.

NORTH AMERICAN OIL CONSOLIDATED, a Corporation,

Respondent.

JUDGMENT U. S. CIRCUIT COURT OF APPEALS.

Upon petition to review an order of the United States Board of Tax Appeals.

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals and was duly submitted.

On consideration whereof, it is now here ORDERED AND ADJUDGED by this court that the decision of the said Board of Tax Appeals in this cause be, and hereby is reversed.

[Endorsed]: Judgment. Filed and entered Jun. 15, 1931. Paul P. O'Brien, Clerk.

At a stated term, to wit, the September term, A. D. 1931, of the United States Circuit Court of Appeals for the Ninth Circuit, held at the courtroom, in the City of Seattle, in the State of Washington, on Monday, the fourteenth day of September, in the year of our Lord one thousand nine hundred thirty-one. Present: The Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding; Honorable WILLIAM H. SAWTELLE, Circuit Judge.

[Title of Cause.]

ORDER DIRECTING MODIFICATION OF OPINION AND DENYING PETITION FOR A REHEARING, ETC.

By direction of the Court, IT IS ORDERED that the opinion heretofore filed by this court in above cause on June 15, 1931, be modified pursuant to opinion this day rendered and filed.

IT IS FURTHER ORDERED that the petition of respondent, filed July 15, 1931, for a rehearing of above cause be, and hereby is denied.

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[Title of Court and Cause.]

AMENDED OPINION U. S. CIRCUIT COURT OF APPEALS.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

Before WILBUR and SAWTELLE, Circuit Judges, and NETERER, District Judge.

WILBUR, Circuit Judge.—Petitioner seeks to review a decision of the Board of Tax Appeals with relation to a deficiency tax of respondent for income and profit taxes for the year 1917. The sole question involved is whether or not the sum of $171,972.20 derived from the sale of oil produced on section 2 during the year 1916 impounded in the hands of a receiver appointed by the federal court for that purpose and retained by him until 1917, when, under order of court it was turned over to the respondent, was taxable as income for the year 1917. The land which produced this oil was government land which had been in the possession of the respondent under placer mining claims. The government contended that as the land had been withdrawn from location by an order of President Taft the respondent was not entitled to a patent. An action was brought to terminate the respondent's right and in that action the receiver was appointed. The respondent was a large operating company holding many pieces of property and this litigation affected only the property in section 2. The trial court determined the matter in favor of the respondent (U. S. vs. No. Am. Oil Co., 242 Fed. 723). This decision was affirmed by the Circuit Court of Appeals of this circuit (264 Fed. 336). The case was finally disposed of by the Supreme Court on March 21, 1922, when it issued its mandate dismissing the appeal thereto in pursuance of a stipulation of counsel. The money thus impounded had been paid over to the respondent after the decision of the district court in 1917.

The Board of Tax Appeals held, in accordance with the contention of the respondent, that the income impounded by the receiver should have been returned by him as his income for the year 1916. In that regard we quote from the opinion of the Board of Tax Appeals as follows:

> "The respondent affirmatively alleges that the amount impounded in the hands of the receiver in 1916 and released to petitioner in 1917 was income to the petitioner in the latter year. The respondent's principal argument in support of his claim herein is that petitioner was on the cash receipts and disbursements basis in the years 1916 to 1919, inclusive, and, as the amount here involved was not actually received by the petitioner until 1917 it must be taxable income in that year. We think it immaterial whether petitioner's accounts were kept on the receipts and disbursements basis or some other basis as permitted by section 13(d) of the Revenue Act of 1916. The fact is that the income was actually produced in 1916. The sole reason that it did not reach the petitioner in that year was because of the suit by the United States. By reason of that suit a receiver was appointed, who actually received the income, and who should have reported it for taxation. Section 13(c) of the Revenue Act of 1916; United States vs. Chicago & E. I. Ry. Co., 298 Fed. 779; Forstmann vs. Ferguson, 17 Fed. (2d) 659, affirmed, 25 F. (2d) 47. If the receiver did not report it, that is no suffi-

cient reason for taxing the petitioner on it in a later year. Accordingly, the amount of $171,979.22 received by petitioner in 1917 is not an item of income in that year."

The petitioner contends that § 13(c) of the Revenue Act of 1916, 39 Stats. 756, does not apply, for the reason that it is inapplicable to a receiver holding only a part of the property of the taxpayer corporation. This section provides for returns by receivers where they are operating "the property of business of corporations," etc. It is provided that they "shall make returns of net income as and for such corporations, * * * in the same manner and form as such organizations are hereinbefore required to make returns." It provides that the tax should be assessed in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody or control. It will be observed that as applied to the receiver having possession of the entire property of the corporation, etc., as in the case of receiver in bankruptcy, the statutory provisions with reference to such taxation are readily applicable but where only a portion of the property of the corporation is in the hands of a receiver it would follow that only a portion of the income of the corporation was in the possession of the receiver and the tax could not be assessed and collected in the same manner as if assessed directly against the taxpayer, unless for purposes of assessment and collection it was in some fashion combined with the income, if any, received directly by the corporation or in case of loss by the

corporation and corresponding reduction was made therefrom. While this consideration does not necessarily determine the proper interpretation of the statute (§ 13(c) *supra*) it clearly points to the conclusion that § 13(c) applies only to receivers who are operating the entire property or business of a corporation, etc. The Secretary of the Treasury, soon after the enactment of the statute in 1916 adopted regulations based upon that view of the statute (Art. 26, par. 181, Art. 209). We quote therefrom as follows:

> " * * * such receiver, trustee, or assignee stands in the place of the corporate officers and is required for the purpose of this title to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. The income which he receives on account of the business transacted is the income of the corporation and, no matter how such income is applied, it is subject to the tax imposed by this title insofar as it exceeds the deductions or allowances authorized by law."

Later additional regulations were promulgated pursuant to 40 Stat. 1057, 1058:

> "A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. * * * A receiver of the rents and profits appointed

to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common-law receivers of all the property or business of an individual or corporation must make returns."

Article 622, after providing for returns of income by receivers, concludes as follows:

"A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. See articles 424 and 547."

Similar provisions were incorporated in the regulations promulgated under later statutes. If in any case it is proper for a receiver to withhold a return of income on the ground that the property in his custody does not constitute all of the property of the taxpayer, it is clear that where the receiver is appointed because of a controversy over the title to the property which he holds which is only a part of that owned by the taxpayer, it is preeminently a case in which the return should not be made by the receiver who has been appointed for the very purpose of impounding the income to await the determination of the court as to its ownership. If it is to be treated as a part of the income of the owner of the property the amount of tax thereon

would depend upon which one of the two litigants was subsequently determined to be the owner, and this difficulty is particularly marked in the situation presented by the case at bar where if the income belonged to the government it was not subject to tax, whereas, if it belonged to the respondent the amount of tax thereon would depend upon the income derived by the respondent taxpayer.

We are informed by the brief filed on behalf of the government that the uniform practice of the Treasury Department with relation to returns from receivership has been in accordance with the rules of the Treasury Department as above interpreted and that under that practice the receiver of a part only of respondent's property as in the case at bar was neither required nor permitted to make such return.

In view of the departmental construction placed upon the statute, which seems to be in accordance with the intent of Congress, the receiver was not required to make return of this income, but the respondent corporation was required to do so.

It remains to consider whether or not the respondent, who was entitled to the income derived from its property which was impounded by the receiver, was liable for income tax thereon as a part of its income for the year 1917. The petitioner asserts in his brief that respondent made its return upon a cash rather than upon an accrual basis. The returns would indicate this to be true for it is expressly stated therein that the returns are based upon receipts and disbursements. Respondent,

however, takes issue with the petitioner's statement and points out that the Board of Tax Appeals failed to determine whether or not respondent's returns were made upon a cash or accrual basis. In either view we think that the amount of this income was properly taxed as income for the year when it was received by the respondent. If the returns were made upon a cash basis it is clearly taxable in the year in which the money was actually received. If, on the other hand, the respondent made its returns upon the accrual basis, as it seems now to contend, it is properly taxable in the year 1917, for it has been held that where tax returns are made upon the accrual basis obligations whose validity is a subject of litigation, is not taxable as accrued income. (Dodge vs. United States, 64 Ct. Cls. 178; Kales vs. Woodworth, 20 F. (2d) 395; Lucas vs. North Texas Co., 281 U. S. 11; Lucas vs. Am. Code Co., 280 U. S. 445.) The respondent, apparently conceding this rule, taxes the position that notwithstanding the fact that it actually received the income in 1917, its right thereto was in litigation until the final decision of the Supreme Court of the United States in 1922, and that therefore the money was not taxable as income until such final determination.

It is said that the Consolidated Tea Co. vs. Bowers, 19 F. (2d) 382, is directly in point on the proposition that the impounded funds cannot constitute income in 1917, but were reportable as income either in 1916 or 1922. We do not think that this case is in point for it deals with the question

as to whether or not the taxpayer is entitled to deduct as a loss a judgment for $10,000 rendered against it by the lower court in 1919, and affirmed by the appellate court and paid in 1921. The taxpayer in that case claimed the right to deduct the loss in 1919 because at that time it set up a reserve against the amount of the judgment. In that connection the district court stated:

> "From a tax income standpoint, both logical and practical reasons seems to me to support the conclusion that a loss should be deductible not in the year when the judgment was rendered but in the year when the claim was adjudicated to be final and definite, or possibly, under certain circumstances, in the year when the claim originated."

We do not think this case is authority for the proposition that money paid to a corporation as a part of its income is not taxable because its right to receive such income is being litigated in the court.

The decision of Burnet vs. Sanford & Brooks, 282 U. S. 359, supports the view that we have advanced. In that case Sanford & Brooks were engaged in dredging for the government. In 1915 they declined to proceed with the work and brought suit against the government for the amount expended in performance of the contract on the ground that the government had failed to make proper disclosure of the character of the dredging to be done. The Court of Claims awarded a judgment against the government in 1918. This judgment was affirmed by the Supreme Court in 1920

(U. S. vs. Atlantic Dredging Co., 253 U. S. 1), and the judgment was paid by the government in 1920. It was contended by the taxpayer that it was entitled to make return of this amount as income for the years 1913–14–15–16, during which the work was done and money expended, with the result that such expenditures made during those years would offset the income. The Supreme Court held that the income was properly taxable as income for the year 1920, there being no evidence that the taxpayer took advantage of the regulation providing for reporting income on long-term contract basis under treasury regulations, or upon an accrual basis under section 212(b).

Income is ordinarily taxable only when it is received. See, also, decision in Herold vs. Mutual Benefit Life Ins. Co., 201 Fed. 918; Maryland Casualty Co. vs. U. S., 251 U. S. 342; Eisner vs. Macomber, 252 U. S. 189, 207; Eckert vs. Burnet, decided April 13, 1931; Lucas, Commissioner, vs. No. Texas Oil Co., 281 U. S. 11; Commissioner vs. Garber, No. 6219 (C. C. A. 9), decided June 8, 1931.

Order reversed.

[Endorsed]: Amended Opinion. Filed Sept. 15, 1931. Paul P. O'Brien, Clerk.

[Title of Court and Cause.]

CERTIFICATE OF CLERK U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing two hundred and three (203) pages, numbered from and including 1 to and including 203, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the respondent and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

ATTEST my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 4th day of December, A. D. 1931.

[Seal] PAUL P. O'BRIEN,
Clerk.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed January 25, 1932

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(1705)

FILE COPY

Office Supreme Court
DEC 14 1
CHARLES ELMORE

# In the Supreme Court
OF THE
# United States

OCTOBER TERM, 1931

No. 575

NORTH AMERICAN OIL CONSOLIDATED
(a corporation),
*Petitioner,*

vs.

DAVID BURNET, Commissioner of Internal Revenue,
*Respondent.*

**Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit and Brief in Support Thereof.**

HERBERT W. CLARK,
Crocker Building, San Francisco, California,
*Attorney for Petitioner.*

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# In the Supreme Court
OF THE
# United States

OCTOBER TERM, 1931

No.

NORTH AMERICAN OIL CONSOLIDATED
(a corporation),
*Petitioner,*

vs.

DAVID BURNET, Commissioner of Internal Revenue,
*Respondent.*

**Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit**

*To the Honorable Charles Evans Hughes, Chief Justice of the Supreme Court of the United States, and to the Associate Justices of the Supreme Court of the United States:*

The petition of North American Oil Consolidated, a corporation, for a writ of certiorari directed to the

United States Circuit Court of Appeals for the Ninth Circuit, respectfully shows:

Petitioner, North American Oil Consolidated, a corporation, was the respondent before both the United States Board of Tax Appeals (Docket Nos. 8714 and 16,107) and the United States Circuit Court of Appeals for the Ninth Circuit, the Commissioner of Internal Revenue having been the petitioner before both tribunals. In this petition, and in the brief which follows, the North American Oil Consolidated will be referred to as "Petitioner" or "Petitioner Company," and the Commissioner of Internal Revenue as "Respondent" or "Respondent Commissioner."

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## NATURE OF PROCEEDINGS.

1. This proceeding is brought and this petition is filed to review the decision of the United States Circuit Court of Appeals for the Ninth Circuit in the case of David Burnet, Commissioner of Internal Revenue, Petitioner, v. North American Oil Consolidated, a corporation, Respondent, which was filed and entered on ~~June~~ September 15, 1931 (R. ~~182-183~~ 184) and is reported in 50 F. (2d) at page 752. ~~A copy of that opinion will be found also in the printed transcript of record at pages 184-198.~~ In accordance with Rule 29 of the said Circuit Court of Appeals, a petition for rehearing was presented by the Petitioner herein on July 15, 1931 (R. 194) and thereafter, on September 15, 1931 (R. 203), the said Court filed an amended opinion and an order directing the modification of its original opinion and denying the said petition for rehearing.

(R. 194.) The ~~amended~~ opinion of the said Court will be found at pages ~~194-203~~ 184-196 of the printed transcript of record herein.

2. The jurisdiction of this Court is invoked under subdivisions (a) and (c) of Section 240, amended, of the Judicial Code (U. S. C. A. title 28, sec. 347; Mar. 3, 1891, c. 517, sec. 6, 26 Stat. 828; Mar. 3, 1911, c. 231, sec. 240, 36 Stat. 1157; Feb. 13, 1925, c. 229, sec. 1, 43 Stat. 938), which read as follows:

> **"Certiorari to circuit courts of appeals and Court of Appeals of District of Columbia; appeal or writ of error to Supreme Court from circuit courts of appeals in certain cases; other reviews not allowed.** (a) In any case, civil or criminal, in a circuit court of appeals, or in the Court of Appeals of the District of Columbia, it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, whether Government or other litigant, to require by certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by it with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted writ of error or appeal.
>
> * * * * * * *
>
> (c) No judgment or decree of a circuit court of appeals or of the Court of Appeals of the District of Columbia shall be subject to review by the Supreme Court otherwise than as provided in this section."

3. The case is a proceeding instituted originally before the United States Board of Tax Appeals by the Petitioner herein as an appeal from a determina-

tion of a deficiency in income and profits taxes for 1917 by the Commissioner of Internal Revenue, the Respondent herein. (R. 10-42; 45-51; 53-78.)

4. From a decision by the United States Board of Tax Appeals (R. 145-146) in favor of the Petitioner herein, the Commissioner of Internal Revenue, Respondent herein, filed his petition for review and assignments of error in the United States Circuit Court of Appeals for the Ninth Circuit (R. 146 et seq.), and that Court reversed the order of the United States Board of Tax Appeals. It is the judgment of the said Circuit Court of Appeals reversing the order of the said Board which the Petitioner herein desires to have reviewed.

5. The only question involved is whether or not certain income from oil produced and sold in 1916, and impounded in the hands of a receiver during that year and turned over to the Petitioner herein in 1917, is taxable income to the Petitioner in 1916, as held by the said Board of Tax Appeals, or in 1917, as held by the said United States Circuit Court of Appeals, or in some other year. The case arises under Sections 10 and 13 of the Revenue Act of 1916, 39 Stat. 756, c. 463, and Sections 4, 201 and 1206 of the Revenue Act of 1917, 40 Stat. 300, c. 63.

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## SUMMARY OF MATTER INVOLVED.

1. On July 15, 1913, the Petitioner herein acquired by purchase certain oil producing properties described as Section 2, Township 32 South, Range 23 East, M.

D. B. & M., Kern County, California. This section was included in the lands described in Temporary Petroleum Withdrawal No. 5,[1] which was issued by President Taft on September 27, 1909, and which was the cause of the litigation in the case of *U. S. v. Midwest Oil Co.*, 236 U. S. 459. Legal title to Section 2 was in the United States at the date of the withdrawal order, and no discovery of oil had been made. Subsequent to the date of the withdrawal order, and sometime prior to November 30, 1915, suit was begun by the United States against the Petitioner herein, and others, "to obtain a decree adjudging that the defendants thereto had no right or interest in a certain section of the then public land of the United States known and described as Section 2, Township 32 South, of Range 23 East of the Mt. Diablo Base and Meridian, or in any of the oil, gas, or other mineral contained therein, for the appointment of a receiver of the property, for an injunction, and an accounting of the oil that had been extracted from the land." (*U. S. v. North American Oil Consolidated et al.* (C. C. A. 9), 264 Fed. 336.) On February 3, 1916, the District Court of the United States, for the Southern District of California, Northern Division, appointed a receiver for the property "and of the oil, gas, and other property of every kind

1. Entitled "Temporary Petroleum Withdrawal No. 5," the text of this order was as follows:

"In aid of proposed legislation affecting the use and disposition of the petroleum deposits on the public domain, all public lands in the accompanying lists are hereby temporarily withdrawn from all forms of location, settlement, selection, filing, entry, or disposal under the mineral or nonmineral public-land laws. All locations or claims existing and valid on this date may proceed to entry in the usual manner after field investigation and examination."

The list attached to the order described lands which included Section 2, Township 32 S., Range 23 E., M. D. B. & M., Kern County, California. See *U. S. v. Midwest Oil Co.*, 236 U. S. 459, at p. 467.

now situated on the said land or already extracted therefrom * * *." The receiver was directed to operate the property and to collect all moneys from the sale of oil. He was permitted to allow the Petitioner herein to operate the property (R. 116-120), and at all times during the period of the receivership "said Section 2 was in the physical possession of and operated by" the Petitioner herein. (R. 163.) In addition to the said Section 2, the Petitioner herein was then operating other oil lands which were not involved in the said case of *United States v. North American Oil Consolidated, et al.,* supra, and which were not involved in the said receivership. (R. 93 et seq.)

2. During the period from February 2, 1916, to December 31, 1916, the receiver received and impounded net income from oil produced from Section 2 during that period in the amount of $171,979.22. (See Findings of Board of Tax Appeals, R. 123.)

The order appointing the receiver was vacated by the District Court on June 5, 1917 (R. 120, 121, 122), and at that time the receiver turned over to the Petitioner herein the net income earned from the said property during the period of the receivership in the year 1916, the District Court holding (242 Fed. at 724-725) that on September 27, 1909, the date of the above mentioned withdrawal order, the Petitioner Company's predecessor in interest "was an actual bona fide occupant and claimant of the property * * *, for the purpose of acquiring title under the mining laws," and that it was in diligent prosecution of work leading to discovery within the meaning of the Pickett Act. Thereupon the Government appealed (242 Fed. 723,

264 Fed. 336) and the suit was finally disposed of by the Supreme Court of the United States in its mandate of March 21, 1922, which directed the dismissal of the appeal, pursuant to stipulation. (For text of mandate see R. 121, 122.) Thus at the late date of March 21, 1922, the Petitioner Company for the first time became assured by Court decision that on and at all times subsequent to September 27, 1909 (the date of the withdrawal order), and even including the year 1916, it and its predecessors in interest were entitled to the possession of the said Section 2, as against the Government, and had the right to extract the oil and gas and to sell and derive income therefrom, although during the period of February 3, 1916-December 31, 1916 income from the said section had, on motion of the Government, been impounded in the hands of a receiver.

3. In the proceeding before the United States Board of Tax Appeals, the respondent herein stipulated **"That at all times during said receivership the income from oil produced on said Section 2 was entered on the books of the North American Oil Consolidated (the Petitioner herein) as its income."** (R. 163.)

4. The United States Board of Tax Appeals expressly found that, **"At all times during the receivership the income from the oil produced from Section 2 was entered on the books of the petitioner (North American Oil Consolidated) as its income.** The income from said Section 2 was not included in the petitioner's original return for 1916 which was filed in March, 1917, **but was included in its amended return**

for 1916, which was filed on March 27, 1918. By letter dated March 23, 1918, attached to the amended return, the respondent was fully advised as to all the facts regarding the litigation and receivership. A revenue agent made an examination of the petitioner's books in 1920." (R. 122-123.) (For text of letter see R. 173-175.)

5. In the proceeding before the United States Board of Tax Appeals the record shows that until sometime after the Petitioner herein had appealed to that Board, the Commissioner had not contended that the impounded funds were taxable to the Petitioner in 1917. The contention that they were taxable to the Petitioner herein in 1917 was first made by the Respondent Commissioner in 1927 in the form of an affirmative defense during the pendency of the proceeding before the Board. (R. 46-47, pars. (7), (8) and (9).)

In its opinion the Board of Tax Appeals states that "the respondent affirmatively alleges that the amount impounded in the hands of the receiver in 1916 and released to petitioner in 1917 was income to the petitioner in the latter year." (R. 139.)

6. The United States Board of Tax Appeals deeming it to be "immaterial whether petitioner's accounts were kept on the receipts and disbursements basis or some other basis as permitted by Section 13 (d) of the Revenue Act of 1916 (39 Stat. 771)," held that the receiver should have reported the impounded funds for taxation in 1916 and that his failure to do so was "no sufficient reason for taxing the petitioner on it in a later year." (R. 139-140; 50 F. (2d) 752, at p.

754, first col.) The Board made no express finding that the accounts of the Petitioner were kept on either the accrual or the cash basis unless the findings set out in paragraph 3 above can be said to be tantamount to a finding that the Petitioner's accounts were kept upon the accrual basis.

7. The United States Circuit Court of Appeals, in its ~~first~~ opinion (50 Fed. (2d) 752, at p. 755) decided (1) that "in view of the departmental construction placed upon the statute (Section 13, subdivision (c), Revenue Act of 1916, 39 Stat. 756, 771), which seems to be in accordance with the intent of Congress, the receiver was not required to make a return of this income (the impounded funds), but the respondent corporation (North American Oil Consolidated) was required to do so," and (2) that the impounded funds were properly taxable as income for the year when they were received by the Petitioner herein (the year 1917) regardless of whether or not the Petitioner's returns were made upon a cash or accrual basis. In this second opinion the said Circuit Court of Appeals corrected its first opinion in several particulars and then adhered to its original decision.

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**IMPORTANCE OF QUESTION PRESENTED AND REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT.**

The decision of the Circuit Court of Appeals in the instant case stands for the grossly inequitable proposition that the Government itself may, with one hand, prevent income from reaching its real owner in the year in which it is produced and, with the other hand,

take a larger share of taxes than would be collectible otherwise, solely because the Government itself prevented the income from reaching the owner during the year in which it was produced. The consequences of this construction of the taxing statutes are obviously unjust and it is submitted that the language of the statutes does not compel that result.

This case is of great importance to the Petitioner and, as well, it is believed, to numerous other oil companies whose funds were, upon the application of the Government, impounded in the hands of a receiver during the period of years when the oil land withdrawal orders, beginning with the above mentioned withdrawal order of September 27, 1909, were causing litigation over the titles to oil properties in California, and were resulting in the impounding in a receiver's hands of the production from the properties, the titles to which were in litigation between the Government and the claimants.

The reasons relied on for the allowance of the writ are:

In reversing the order of the Board of Tax Appeals the learned Circuit Court of Appeals placed its decision on the grounds, first, that the receiver appointed in the case of *United States v. North American Oil Consolidated et al.,* supra, "was not required to make return of this income (the income impounded during the period February 3, 1916-December 31, 1916), but the respondent corporation (the Petitioner Company) was required to do so" (50 F. (2d) 755), because subdivision (c) of Section 13 of the Revenue Act of 1916, 39 Stat. 756, 771, providing for returns by receivers

where they are operating all, and not part of, "the property or business of corporations" (50 F. (2d) 754), although the litigation in which the receiver was appointed was between the Government and the Petitioner Company; and, secondly, irrespective of the basis of accounting employed by the Petitioner Company, and largely if not wholly upon the supposed authority of *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, that "the amount of this income was properly taxed as income for the year when it was received by" the Petitioner Company. (50 F. (2d) 755.)

1. The question here decided,—that a receiver in charge of only a part of the property of a corporation is not required to make a tax return under the provisions of Section 13 (c) of the Revenue Act of 1916—has not been passed upon by this Court, so far as Petitioner herein has been able to learn. The section itself, which is set out in the brief which follows this petition, contains no exception or limitation which would seem to warrant the construction placed upon it by the learned Circuit Court of Appeals, and the regulations relied on by the Circuit Court of Appeals find no support in either Section 13 (c) or subsequent acts.

2. The second ground of the decision of the learned Circuit Court of Appeals—that, whether on the accrual or the cash basis, the impounded funds were properly taxable to the Petitioner Company in 1917 because they were physically received by the Petitioner in that year, although the effect of the decisions in *United States v. North American Oil Consolidated, et al.*, supra, was that the Petitioner was at all times

entitled to the income—seems to be invalid for at least two reasons: (a) If the Petitioner was on the accrual basis of accounting the impounded funds were accrued as income in 1916, under the finding of the Board of Tax Appeals, and on plain principles were taxable to the Petitioner in that year; and (b) if the Petitioner was on the cash basis of accounting, its right to the impounded funds was not determined until 1922, and, it would seem, the funds were "impounded funds" at all times until March 21, 1922, although they were received by the Petitioner in 1917.

Wherefore, your Petitioner respectfully prays that a writ of certiorari may issue to the United States Circuit Court of Appeals for the Ninth Circuit commanding that Court to certify and send to this Court a full and complete transcript of the record of all proceedings of the said Court in the above entitled case, to the end that the said case may be reviewed and determined by this Court, as provided by law.

Dated, San Francisco, California,
December 9, 1931.

NORTH AMERICAN OIL CONSOLIDATED,
By HERBERT W. CLARK,
*Its Attorney.*

# In the Supreme Court
OF THE
# United States

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OCTOBER TERM, 1931

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No.

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NORTH AMERICAN OIL CONSOLIDATED
(a corporation),
*Petitioner,*

vs.

DAVID BURNET, Commissioner of Internal Revenue,
*Respondent.*

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## Petitioner's Brief.

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### JURISDICTION OF THE CASE.

This proceeding is brought, and this petition is filed, to review the decision of the United States Circuit Court of Appeals for the Ninth Circuit in the case of *David Burnet, Commissioner of Internal Revenue, Petitioner, v. North American Oil Consolidated, a corporation, Respondent.* The case was originally

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Unless otherwise indicated italics have been supplied.

decided by the said Circuit Court of Appeals on the 15th day of June, 1931, and Petitioner's petition for a rehearing in that Court was denied on the 15th day of September, 1931. The original opinion will be found at pages 184-193 of the transcript of record herein. The opinion rendered upon the petition for rehearing appears in 50 F. (2d) 752, and a copy thereof, together with a copy of the order denying the petition for a rehearing, appears in the transcript of record at pages 194-203.

The jurisdiction of this Court is invoked under subdivisions (a) and (c) of section 240, as amended, of the Judicial Code, U. S. C. A. title 28, section 347, which are set forth in the foregoing petition for writ of certiorari at pages 2 and 3.

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## STATEMENT OF THE CASE.

The parties are described and identified in the foregoing petition for writ of certiorari at page 2, and the nature of the proceedings is described therein at pages 2-4.

The facts of the case are briefly stated in the foregoing petition at pages 4 to 9; the proceedings before the United States Board of Tax Appeals and before the said Circuit Court of Appeals are set forth in the foregoing petition at pages 7 to 9; all with appropriate page references to the printed record herein.

## SUMMARY OF ARGUMENT.

The impounded funds should have been reported by the receiver for taxation in 1916. If the impounded funds should not have been reported by the receiver for taxation in 1916, they were taxable to the Petitioner Company in that year because they constituted accrued income of the Company for that year.

On the other hand, if the impounded funds should not have been reported as income in 1916 by either the receiver or the Petitioner Company, then they should not have been reported at all prior to the year 1922, which was the year in which the litigation was finally terminated in favor of the Petitioner Company.

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## POINT ONE: THE IMPOUNDED FUNDS SHOULD HAVE BEEN REPORTED BY THE RECEIVER FOR TAXATION IN 1916.

The Petitioner herein submits that the learned Circuit Court of Appeals was wrong in holding that the receiver was not required to make return of the impounded funds for taxation in 1916.

Section 10 of the Revenue Act of 1916 (c. 463, 39 Stat. 756) reads as follows:

> "That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income;

* * * * * * *

The foregoing tax rate shall apply to the total net income received by every taxable corporation, joint-stock company or association, or insurance company in the calendar year nineteen hundred and sixteen and in each year thereafter, * * *."

Section 13 (a) and (c) of the same Act, so far as pertinent, read as follows:

"(a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first: * * *.

* * * * * * *

(c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control; * * *."

Section 4 of the Revenue Act of 1917 (c. 63, 40 Stat. 300) provides for the levying and collecting of an additional tax of four per centum "upon the income received in the calendar year 1917"; and section 10 (a) of the same Act provides for the levying and

collecting of an additional tax of two per centum of the net income "received in the preceding calendar year." (See Appendix A for complete text of pertinent portions of these sections.)

Regulations 33 (revised) were promulgated pursuant to section 1005 of the Revenue Act of 1916, supra. Articles 26 and 209 relate to receivers and, so far as they are pertinent to the question here involved, they are as follows:

"Art. 26.

* * * * * * *

Par. 181. Receivers who, as officers of a court, stand in the stead of some principal are required to account for income tax as the principal would have been required to account.

Art. 209. *Receivers to make returns.*—Section 13, paragraph C, of this title requires receivers, trustees in bankruptcy, or assignees, who are in charge of and are operating the property and business of corporations, to make returns of annual net income and pay any income tax thereby shown to be due, regardless of what disposition, subject to the orders of the court, may be made of such income.

Notwithstanding the fact that the powers and functions of the corporation are suspended and that the property and business are for the time in control and custody of the receiver, trustee, or assignee, subject to the orders of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required for the purpose of this title to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. The income which he receives on account

of the business transacted is the income of the corporation and, no matter how such income is applied, it is subject to the tax imposed by this title in so far as it exceeds the deductions or allowances authorized by law.

The receiver, trustee, or assignee acting for the corporation, is required to make a true and accurate return of annual net income covering each year or part of each year during which he is in custody and control of the business or properties and will be liable to all the penalties imposed by this title for failure to meet any of its requirements."

It is instantly observable that neither section 13(c) of the Revenue Act of 1916, supra, nor Article 209 of Regulations 33 (revised), supra, which interprets section 13 (c) of the statute, makes any exception in cases of receivers operating only part of the business of a corporation. The section of the statute unequivocally requires a receiver who is operating the property or business of a corporation to "make returns of net income as and for such" corporation. It is significant that the Revenue Act of 1918 changed the requirements as to receivers for **individuals**, but not **as to receivers for corporations**. Section 225 of the Revenue Act of 1918 (see Appendix B for text of section) provides that "every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an **individual** shall make under oath a return for the individual, estate or trust for which he acts" in certain specified cases, but this exception does not even apply under the statute of 1918 if the receiver is in possession of part only

of the property of either an estate or a trust. Section 8 (c) is the corresponding section of the Act of 1916 (see Appendix C for text of section) and contains no exception in the case of receivers in possession of part only of the property of an individual. Section 239 of the Revenue Act of 1918 (see Appendix D for text of section) is substantially the same as section 13 (c) of the 1916 Act, and it makes no exception in the case of receivers in possession of part only of the property of a corporation.

Article 424 of Regulations 45 (see Appendix E), promulgated under the Revenue Act of 1918, contains the following sentence:

> "A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual **or corporation** need not."

The change in the Revenue Act of 1918 as to receivers for individuals evidently inspired this portion of Article 424, but the extension of the exception to receivers for corporations is not warranted by the statute.

Article 622 of Regulations 45 (see Appendix E) contains the following sentence:

> "A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving **merely a small portion of its property,** need not make a return of income."

The Treasury Department apparently had in mind that if the receiver was in possession of "merely a

small portion" of the property of the corporation he should not be burdened with the necessity of making a return, and it is submitted that these sections of the statute should be so interpreted, and that Congress in reenacting section 225 and section 239 of the Revenue Act of 1918 in the subsequent revenue acts, so interpreted these articles of the regulations of the Department. If the regulations are not so interpreted they are not warranted by the language of the statute, particularly when the significant change in section 225 of the Revenue Act of 1918, as compared with section 8 (c) of the Revenue Act of 1916, is contrasted with the fact that no such change is contained in section 239 of the Revenue Act of 1918 as compared with section 13 (c) of the Revenue Act of 1916. It is clear that it is only in the case of **individuals** that a receiver who is in possession of only a part of the property need not render a return, and that such exception does not apply in the case of estates, trusts or corporations, with the possibility that the administrative policy expressed in the regulation, making an exception in the case of receivers holding "merely a small portion" of the property of a corporation, should be sustained.

In this connection the learned Circuit Court of Appeals said (50 F. (2d) 752, at p. 755) that if in the case of a receiver in charge of only a part of a corporation's property, the income impounded by the receiver from such parts of the corporation's property "is to be treated as a part of the income of the owner of the property, the amount of tax thereon would depend upon which one of the two litigants was subsequently determined to be the owner, and this difficulty

is particularly marked in the situation presented by the case at bar, where, if the income belonged to the government, it was not subject to tax, whereas, if it belonged to the respondent, the amount of tax thereon would depend upon the income derived by the respondent taxpayer."

This line of reasoning is, it seems to the Petitioner herein, equally applicable to the case of a receiver who is in possession of all the property of a corporation. Moreover, if the income had actually been held to belong to the Government no tax would have been collectible or payable anyway, whether the income had been derived from a part only or from all the property claimed by and operated by the corporation. In addition it is submitted that the facts in the case at bar are similar to the case of *Ferguson v. Forstmann,* 25 F. (2d) 47, affirming 17 F. (2d) 659. In that case the Alien Property Custodian in 1918 brought two suits against Mrs. Forstmann, who owned certain stock in Forstmann & Huffmann Company. The first was brought to compel her to surrender to the corporation certain shares of stock on the ground that they had been originally paid for by funds of the company. The Alien Property Custodian was a stockholder of the company by virtue of the seizure of some stock of that company owned by Germans. The second suit was brought to compel Mrs. Forstmann to surrender the balance of her shares on the ground that they were owned by alien enemies and as such had been seized by the Alien Property Custodian. While these suits were pending the Court entered an order restraining Mrs. Forstmann from transferring

any of her stock in the company and restraining the company from paying dividends to her. These suits were dismissed March 29, 1921, on motion of the Alien Property Custodian. While the company was under injunction dividends were declared on her stock in the sum of eighty-two thousand one hundred fifteen dollars ($82,115.00) on March 31, 1919, and one hundred thirteen thousand one hundred fifty dollars ($113,150.00) on February 28, 1920. When the suits were dismissed and the restraining orders vacated, these dividends were paid to Mrs. Forstmann. She did not include these dividends in her income tax returns for 1919 and 1920 because she had not received them when these returns were made. On March 15, 1922, she filed amended returns and included the eighty-two thousand one hundred fifteen dollars ($82,115.00) for 1919, and the one hundred thirteen thousand one hundred fifty dollars ($113,150.00) for 1920, and paid additional taxes for those years. Subsequently the Commissioner ruled that the dividends and interest were taxable income for the year 1921, when they were received by Mrs. Forstmann and assessed an additional tax for that year, which she paid under protest and then brought suit to recover; in the meantime Forstmann and Huffmann Company concluded that while the restraining order was in effect it was holding the dividends of Mrs. Forstmann's stock as a trustee or fiduciary, and that under the Revenue Act it was obliged to make a return and pay the tax due on such dividends.

The trial Court held that the dividends were income received and held in trust by the company as a

"fiduciary" for "unascertained persons" as provided in the Revenue Acts of 1918 and 1921. Two main issues were involved: First, whether or not the taxes could be legally assessed against and properly paid by the company as a fiduciary, and, second, whether or not if the taxes should have been assessed against Mrs. Forstmann and not the fiduciary they were assessable against her for 1919 and 1920, when declared, or for 1921 when received. The Circuit Court of Appeals for the Third Circuit reached the conclusion that the company as fiduciary should have paid the taxes upon such dividends during the years 1919 and 1920, and accordingly found it unnecessary to pass upon the second question.

In arriving at this conclusion the Court said:

> "(1). The order of the district Court directed that the dividends, declared and payable in 1919 and 1920, 'be held in the treasury of the company until the final determination in this suit of the true ownership of this stock.' Until this determination the dividends were allowed to accumulate and were held in trust for this 'unascertained' owner. Until then, the Forstmann & Huffmann Company was the trustee, conservator, or a person acting in a fiduciary capacity. While thus restrained from paying the dividends, the company was holding this property for the benefit of some person thereafter to be ascertained and was thus a trustee. Perry on Trusts and Trustees, vol. 1, Sec. 1. Whether or not such trust be express or implied is unimportant, for the statute includes both. It received and held these dividends in trust for some person whose identity was unascertained in 1919 and 1920. It

was thus a fiduciary, within the meaning of Article 1521 of the Regulations 45 and 62.

"(2). While the Forstmann & Huffmann Company was holding these dividends in obedience to the injunctive orders of the court, proceedings were being conducted to ascertain who was entitled to them, and during this time Mrs. Forstmann manifestly could not pay taxes on them. They were income accumulated for the benefit of some person, yet unascertained. The Government was entitled to receive the taxes for the years when the dividends were declared, but there was not one who could safely pay them, except this fiduciary company. It might have been negligent in making its returns, but that did not relieve it of its statutory duty, and it was 'better late than never.'

"The action in these cases is akin to an equitable garnishment or equitable trustee process under statute. Phoenix Insurance Co. v. Abbott, 127 Mass. 558; Pendleton v. Perkins, 49 Mo. 565; Westwater v. Ferguson, 22 Pa. County Ct. 582. The company holding the dividends was an equitable garnishee. Such a proceeding in form is an action at law, but in substance is an action in equity, to determine the ownership of property in dispute, and in some states is called a 'trustee process.' As the relation of debtor and creditor exists between the garnishee and his original debtor, so the relation of debtor and creditor existed between the company and Mrs. Forstmann, although another creditor stepped in and claimed the hitherto undisturbed right of the original creditor.

"The Alien Property Custodian, in bringing these suits and obtaining these injunctions, was

employing substantially equitable processes to establish his equitable rights, alleging that one block of the stock belonged to the company (of which he was a stockholder) because purchased with its money, and the other block, on being seized, belonged to him. Under the injunctive orders, the company was required to hold both of these until the rightful owner was ascertained.

"These proceedings were clothed with the characteristics of a trust within the provision of section 219 (a) of the Revenue Acts of 1918 and 1921. Accordingly, it seems to us that the dividends in question constitute income accumulated 'for the benefit of. * * * unascertained persons,' the tax on which it was the duty of the company as 'fiduciary' to pay."

While the Circuit Court in this case states that it is unnecessary to decide whether if the tax had been assessable against Mrs. Forstmann it should have been assessed in the years 1919 and 1920 instead of 1921, the effect of its decision is that the dividends in question were not taxable to Mrs. Forstmann in either of the three years. This is the necessary inference from the holding of the Court that the tax on the dividends should have been reported by the company as a fiduciary.

The reasoning of the Court in the *Forstmann* case is applicable to the case at bar. The income involved was earned and received in 1916. During that year its ownership was uncertain. A receiver had been appointed by the Court to collect and impound this money. The Petitioner would have received the money

in 1916 had it not been for the action of the Government in securing the appointment of this receiver. As the income was earned and received in 1916 the Government was clearly entitled to receive the tax in that year on this income. Under the statute as it then existed, the receiver was required to make the return of income for 1916 and pay the tax due. The record does not show whether or not the receiver made such a return. Whether he did or not he was legally liable to do so, and the fact that he may not have made a return, is, as the Board points out, not a sufficient reason for imposing a tax on the Petitioner in a different year. The record shows, however, that when Petitioner received from the receiver the moneys earned and received by him during 1916 it filed an amended return for 1916 in which it included this amount.

It is submitted on this phase of the matter that neither section 13 (c), nor any article of the regulations promulgated to carry it into effect, justifies the interpretation placed upon section 13 (c) of the Revenue Act of 1916 by the Circuit Court of Appeals.

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**POINT TWO: IF, HOWEVER, THE IMPOUNDED FUNDS SHOULD NOT HAVE BEEN REPORTED BY THE RECEIVER FOR TAXATION IN 1916, THEY WERE TAXABLE TO THE PETITIONER COMPANY IN THAT YEAR BECAUSE THEY CONSTITUTED ACCRUED INCOME OF THAT COMPANY FOR THAT YEAR.**

The Petitioner has already pointed out in the petition for writ of certiorari that in the proceeding before the United States Board of Tax Appeals the Respondent Commissioner stipulated "That at all

times during said Receivership the income from oil produced on said section 2 was entered on the books of the North American Oil Consolidated as its income" (R. 163); and that the Board of Tax Appeals expressly stated in its opinion herein that the Petitioner Company "accrued in each year on its books the income applicable to the oil produced and sold." (R. 139.) It is also true that in 1917, in filing its tax return for 1916, the Petitioner did not include any part of the impounded funds, although they had been accrued upon its books of account. But in 1918 the Petitioner filed its amended return for 1916 and included all impounded funds as income for 1916, explaining the situation regarding the litigation and the receivership in a letter dated March 23, 1918, which was attached to the amended return. (R. 122-123.)

In its original opinion herein, the Circuit Court of Appeals stated that, "It is admitted that the taxpayer made its income tax returns upon the cash basis." (R. 190.) No such admission was made by the Petitioner Company at any time, and upon petition for rehearing, after its attention had been called to this inadvertency, the Circuit Court of Appeals eliminated from its opinion the sentence just quoted. Undoubtedly the sentence crept into the original opinion because of the fact that in compliance with the request contained in the Respondent Commissioner's form of tax return (R. 169) that the Petitioner Company "State whether or not this return is made upon the basis of actual receipts and disbursements"—the Petitioner Company replied "Yes," and made no response to the suggestion printed on the same form, "If not, describe

just what other basis or method was used in computing net income." But, as stated by the District Court for the Southern District of New York in the case of *Consolidated Tea Co. Inc. v. Bowers, Collector of Internal Revenue,* (1927) 19 F. (2d) 382, at p. 383:

> "The answers at the end of the return are merely informatory; they do not change the facts. At the most, they might be regarded as an intention by the one who prepared the report to have it on a cash basis."

But the Board of Tax Appeals made no finding that the accounts were kept or the returns made on the cash basis. The issue, as already stated, was affirmatively raised by the Respondent Commissioner after he had, in the 1917 sixty-day letter (see Transcript of Record at top of page 23), expressly made a readjustment of income for "taxes in excess of accrual." Inasmuch as the Commissioner had the affirmative of the issue that the impounded funds were taxable in the year 1917, it was incumbent upon him to prove all facts necessary to sustain his contention. One of such facts was that the Petitioner kept its accounts upon the cash basis and/or made its returns upon the cash basis. This burden of proof, to repeat, was upon the Commissioner. (*Appeal of General Lead Batteries Co.,* 2 B. T. A. at p. 395.) But the practically if not wholly undisputed facts indicated that the accounts of Petitioner were kept on the accrual basis and the Commissioner himself, as we have already pointed out, adjusted the 1917 tax return in respect of "taxes in excess of accrual."

The Board of Tax Appeals deemed the question of the basis of accounting and/or the basis of the re-

turn immaterial inasmuch as the decision went off on the question of the duty of the receiver to make return of the impounded funds for 1916 under the mandate of section 13 (c) of the Revenue Act of 1916.

It has been many times held by the Board of Tax Appeals that the present availability or nonavailability of income is immaterial because present beneficial use is not a test of the accrual of income.

See:

*Appeal of Illinois Terminal Co.*, 5 B. T. A. 15;
*Appeal of Cincinnati, Findlay & Ft. Wayne Railway Co.*, 5 B. T. A. 108;
*Appeal of New Orleans, Texas and Mexico Railway Co.*, 6 B. T. A. 436;
*Virginia Carolina Sec. Corpn. v. Commissioner of Internal Revenue*, 6 B. T. A. 84;
*Appeal of S. W. Harris*, 2 B. T. A. 933;
*Appeal of Mead Construction Co.*, 3 B. T. A. 438;
*Appeal of Walter Cravens*, 3 B. T. A. 282.

The real test of accrual seems to be, not availability for beneficial use, but the right of the taxpayer to the income. And in the case at bar it was decided by the federal Courts (*United States v. North American Oil Consolidated, et al.*, supra) that the Petitioner Company had at all times a right to the income in question. That was a necessary resulting incident of the decisions mentioned. And it has been held that the existence of a dispute over the ownership of or right to income does not operate to postpone its accrual. Thus in the case of *Ferguson v. Forstmann,*

supra, it was remarked that the Government's position was tantamount to taxing as Congress had authorized, and by its deferring payments, taking "a larger share than would have been possible but for" the activities of the Alien Property Custodian. The Court said:

> "* * * With one hand it deprived the plaintiff of her income, and with the other it levied a larger tax, when it permitted her to take her income, than could have been levied if the government had not stopped its receipt."

That is precisely what has happened in the case at bar.

It is submitted that the decisions of the federal Courts in the case of *United States v. North American Oil Consolidated, et al.,* supra, necessarily mean that the Petitioner Company herein at all times during 1916 had a legal right to the income produced from the property and impounded in the hands of the receiver. This legal right was a necessary incident to the Petitioner Company's right to Section 2 itself. And this being so it would seem necessarily to follow that, inasmuch as the income from the impounded funds was accrued upon the books of the Petitioner Company as its income in 1916, the impounded funds were taxable to the company in 1916, if they were not reportable by and taxable against the receiver in that year.

**POINT THREE: BUT IF THE IMPOUNDED FUNDS SHOULD NOT HAVE BEEN REPORTED AS INCOME IN 1916 BY EITHER THE RECEIVER OR THE PETITIONER COMPANY, THEN THEY SHOULD NOT HAVE BEEN REPORTED AT ALL PRIOR TO THE YEAR 1922, WHICH WAS THE YEAR IN WHICH THE LITIGATION WAS FINALLY TERMINATED IN FAVOR OF THE PETITIONER COMPANY.**

The case of *Consolidated Tea Company Inc. v. Bowers,* 19 F. (2d) 382 (District Court, New York, 1927), is directly in point on the proposition that the impounded funds cannot constitute income in 1917, but were reportable as income either in 1916 or 1922. Although that case dealt with the time for deducting an obligation which was the subject of litigation, nevertheless the principle is the same as the determination of the time for reporting income which is the subject of litigation. The facts were that prior to 1919 the Tea Company was sued for certain commissions which it was claimed it had failed to pay, and in 1919 a judgment was rendered against the Tea Company for approximately $10,000. The Tea Company set up a reserve in the amount of the judgment and charged the amount to profit and loss. It deducted the amount of the judgment on its income tax return for the year 1919. In January, 1921, the judgment was affirmed by the Appellate Court and paid by the plaintiff. The Court holds that the income tax returns of the Tea Company were made on the accrual basis, although on the returns it was stated that they were made on the basis of actual receipts and disbursements. In holding that even though the returns were rendered on the accrual basis, nevertheless the amount of the judgment could not be deducted until 1921, when the litigation was finally terminated, the Court said:

"It seems to me that *the time of the mere rendering of a judgment is not the controlling* factor in determining when a loss is sustained. It has no particular significance in this case. From all that appears in the record the services may have been rendered or the damage occurred upon which the judgment was founded prior to 1919; in fact, it was conceded upon the argument of the motion to dismiss that *the action against the Tea Company had been pending for some two years* before it was reached for trial in 1919, and further it does not appear that the claim in the action against the Tea Company was an unliquidated one.

"*From a tax income standpoint, both logical and practical, reasons seem to me to support the conclusion that a loss should be deductible not in the year when the judgment was rendered but in the year when the claim was adjudicated to be final and definite, or possibly, under certain circumstances, in the year when the claim originated.*

* * * * * * *

"The plaintiff, the Consolidated Tea Co., Inc., sued to recover a portion of the tax it was compelled to pay for the year 1919, and it bases this right to a refund on the ground that the amount of the judgment rendered against it in 1919 was a proper deduction for that year, and *while it is not necessary in deciding this case, and is probably inadvisable with the present record to determine whether the loss in question may have been deductible at the time the services were rendered or the damage occurred upon which the judgment against the Tea Company was founded, or was deductible when the judgment was affirmed and paid, I think it is clear that it*

*was not deductible in 1919,* and accordingly a verdict is directed in favor of the defendant."

The following decisions support the position that a judgment is not deductible in the year in which it is entered in the lower Court where an appeal is taken, but should be deducted upon the final termination of the litigation:

*Farmers Nat'l. Bank of Rome v. Commissioner,* 6 B. T. A. 1036;

*Jewell v. Commissioner,* 6 B. T. A. 1040;

*Lehigh & Hudson River Ry. v. Commissioner,* 13 B. T. A. 1154; affirmed by Circuit Court of Appeals in 36 F. (2d) 719, as modified by 38 F. (2d) 1015; certiorari denied May 5, 1930.

The learned Circuit Court of Appeals apparently placed great reliance upon the decision of *Burnet v. Sanford & Brooks Co.,* 282 U. S. 359. But that case is, it is submitted, clearly distinguishable from the case at bar. In that case the Sanford & Brooks Co. was engaged during the years 1913, 1914 and 1915 in dredging the Delaware River for the Government at a certain contract price. In December, 1915, the company ceased work and subsequently brought suit against the United States, such suit being based on a breach of warrant of the character of the material to be dredged. Judgment was recovered for the actual loss sustained by the company, being the difference between the payments received under the contract and the amount expended by the company in performance of the contract, such judgment being eventually affirmed by the Supreme Court in 1920. It is obvious

that the recovery of this judgment did not represent money "which should have been paid in the prior years," or "money due during the years of performance of the contract," as contended by the Respondent Commissioner. Sanford & Brooks Co. claimed that the amount recovered was a reimbursement of losses sustained in prior years and was, therefore, not income. They maintained that they broke even on their dredging operations and, therefore, they could not have realized income therefrom; and they proposed to file amended returns for the years 1913, 1915 and 1916, eliminating the dredging loss taken in those years (the operations in 1914 having resulted in a profit). The theory was that there was no loss in those years and no income in 1920. The Supreme Court refused to accept this theory, holding that income must be returned on the basis of fixed accounting periods. The Supreme Court also stated that an exception exists in the case of the regulations relating to long term contracts which permit the reporting of profit or loss at the termination of the work, but stated that the taxpayer had not availed itself of these provisions. It is, therefore, clear that there is no parallel whatever between the *Sanford & Brooks* case and the instant case. Sanford & Brooks Co. did not even contend that the amount recovered constituted income in the years in which dredging operations were carried on, probably for the reason that they realized that the recovery was in the nature of damages and that the amount to be recovered was uncertain until fixed by the Court. By no possibility, therefore, could this amount be construed to be income in any year prior to its recovery. It is true that

Sanford & Brooks attempted to obtain the same result, but only by maintaining that no income whatever was realized, and that, therefore, the amount recovered should not be reported in 1920, since it was not income.

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## CONCLUSION.

It is respectfully submitted that a writ of certiorari should issue as prayed for in the petition herein.

Dated, San Francisco, California,
December 9, 1931.

HERBERT W. CLARK,
*Attorney for Petitioner.*

**(Appendices A, B, C, D and E Follow.)**

# Appendices.

## Appendix A

### PERTINENT PARTS OF REVENUE ACT OF 1917, C. 63, 40 STAT. 300.

Sec. 4. That in addition to the tax imposed by subdivision (a) of section ten of such Act of September eighth, nineteen hundred and sixteen, as amended by this Act, there shall be levied, assessed, collected, and paid a like tax of four per centum upon the income received in the calendar year nineteen hundred and seventeen and every calendar year thereafter, by every corporation, joint-stock company or association, or insurance company, subject to the tax imposed by that subdivision of that section, * * *.

Sec. 201. That in addition to the taxes under existing law and under this act there shall be levied, assessed, collected, and paid for each taxable year upon the income of every corporation, partnership, or individual, a tax (hereinafter in this title referred to as the tax) equal to the following percentages of the net income: * * *

Sec. 1206. (1) That the first paragraph of section ten of such Act of September eighth, nineteen hundred and sixteen, is hereby amended to read as follows:

Sec. 10. (a) That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized, but not including partnerships, a tax of two per centum upon such income; * * *.

## Appendix B

### SECTION 225, REVENUE ACT OF 1918.

That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a non-resident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same, is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this Act shall be subject to all the provisions of this Act which apply to individuals.

## Appendix C

### SECTION 8(c), REVENUE ACT OF 1916.

Guardians, trustees, executors, administrators, receivers, conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the income of the person, trust, or estate for whom or which they act, and be subject to all the provisions of this title which apply to individuals. Such fiduciary shall make oath that he has sufficient knowledge of the affairs of such person, trust, or estate to enable him to make such return and that the same is, to the best of his knowledge and belief, true and correct, and be subject to all the provisions of this title which apply to individuals: *Provided,* That a return made by one of two or more joint fiduciaries filed in the district where such fiduciary resides, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph.

## Appendix B

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That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a non-resident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same, is, to the best of his knowledge and belief, true and correct.

Fiduciaries required to make returns under this Act shall be subject to all the provisions of this Act which apply to individuals.

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## Appendix D

### SECTION 239, REVENUE ACT OF 1918.

That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice-president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent.

In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

Returns made under this section shall be subject to the provisions of sections 226 and 228. When return is made under section 226 the credit provided in subdivision (c) of section 236 shall be reduced to an amount which bears the same ratio to the full credit therein provided as the number of months in the period for which such return is made bears to twelve months.

## Appendix E

### REGULATIONS 45, ARTICLES 424, 622.

Art. 424. *Return by receiver.* A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on form 1040 (revised) or 1040A (revised). When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be be made as if by the corporation itself. See section 239 of the statute and article 622. A receiver in charge of the business of a partnership shall render a return on form 1065 (revised). A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common-law receivers of all the property or business of an individual or corporation must make returns. See also section 256 of the statute and articles 1071-1080.

Art. 622. *Returns by receivers.* Receivers trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on form 1120, covering each year or part of a year during which they are in control. Notwithstanding

that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. See articles 424 and 547.

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# In the Supreme Court
OF THE
# United States

OCTOBER TERM, 1931

**No. 575**

NORTH AMERICAN OIL CONSOLIDATED
(a corporation),
*Petitioner,*

vs.

DAVID BURNET, Commissioner of Internal Revenue,
*Respondent.*

## MEMORANDUM FOR THE PETITIONER,
**(Supplementing Brief in Support of Petition.)**

HERBERT W. CLARK,
Crocker Building, San Francisco, California,
*Attorney for Petitioner.*

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## MEMORANDUM FOR THE PETITIONER.
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Certiorari was granted herein on January 25, 1932 (R. 205), to review a judgment of the Circuit Court of Appeals for the Ninth Circuit (R. 194-203; 50 F. (2d) 752), reversing a decision of the Board of Tax Appeals. (R. 130-145; 12 B. T. A. 68.) All points made in Petitioner's brief in support of the petition

for writ of certiorari are reasserted. This memorandum is intended to supplement that brief.

The nature of the proceedings is set forth at pages 2-4 of the petition for writ of certiorari, and a summary of the matter involved appears at pages 4-9 therein and at pages 2-4 of the **Memorandum for the Respondent.** Although not expressly found as facts by the Board of Tax Appeals, reference to the report of the case of *United States v. North American Oil Consolidated, et al.*, 242 Fed. 723, which is incorporated in the Board's findings by reference (R. 120) discloses, as additional facts, that prior to and on January 1, 1916, and therefore before the date, February 3. 1916, of the order appointing the receiver in the above entitled case, applications for patent to Section 2, Township 32 south, Range 23 east—the land as to which the receiver was appointed on February 3, 1916—were pending in the United States Land Office. (R. 124.) It was upon and pursuant to these applications that the patent of 1922 was issued after the Supreme Court dismissed the Government's appeal. (R. 128.) Moreover, on various dates after May 4, 1910, and before the commencement of *United States v. North American Oil Consolidated, et al.*, supra, oil in commercial quantities had been discovered on each quarter section of Section 2. (See 242 Fed. 723, 726.) The two questions raised in the case of *United States v. North American Oil Consolidated, et al.*, were: (1) On September 27, 1909, the date of the withdrawal order, was the claim of Section 2, "a location or claim existing and valid," and therefore

excluded from the operation of the withdrawal order? and (2) was the Pioneer Midway Oil Company (which was a predecessor in interest of this Petitioner) an actual bona fide occupant and claimant of section 2 on September 27, 1909, for the purpose of acquiring title under the mining laws, and then in diligent prosecution of work leading to discovery, within the meaning of the Pickett Act?* The District Court answered the second question in the affirmative and, in consequence, found it unnecessary to answer the first. And, as we have stated at page 6 of the petition herein, the Government's bill was dismissed on June 5, 1917, the receiver was discharged, and the impounded funds were turned over to the North American Oil Consolidated.

As stated in paragraph 5 on page 4 of the petition herein, the ultimate question for decision in this case is as to whether or no income from oil produced and sold in 1916, impounded in the hands of the receiver during the period February 3, 1916-December 31, 1916, and turned over to the Petitioner herein in 1917, is, under the circumstances of this case, taxable income in 1916 to the Petitioner (which at all times claimed the land from which the money was produced), as was held by the Board of Tax Appeals, or in 1917, as was held by the Circuit Court of Appeals, or in some other year. The answer to this question

*The Pickett Act (36 Stat. 847) contained a proviso reading as follows: "That the rights of any person who, at the date of any withdrawal order heretofore or hereafter made, is a bona fide occupant or claimant of oil or gas bearing lands, and, who at such date is in diligent prosecution of work leading to discovery of oil or gas, shall not be affected or impaired by such order so long as such occupant or claimant shall continue in diligent prosecution of said work."

depends, we believe, upon the answer to be given to certain other questions, and, as we see the situation, such other questions are:

1. Does the income tax law require the **right** to income to be unconditional before the income itself could be properly accrued on the books of account of the Petitioner as accrued income of the Petitioner for the year 1916?

2. Assuming that the Petitioner's basis of accounting was cash and not accrual, was the income paid to it by the receiver in 1917 taxable income to it in that year, notwithstanding the undeniable fact that its **right** thereto did not become unconditional until 1922, when the Government's appeal was dismissed?

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## ARGUMENT.

### I.

### UNCONDITIONAL RIGHT TO INCOME IS NOT A CONDITION PRECEDENT TO THE ACCRUABILITY OF INCOME.

We know of no case dealing with this precise question; but in *Lucas v. American Code Company,* 280 U. S. 445—a case dealing with the question of the year in which a loss should be deducted—the Court said:

> "Generally speaking, the income-tax law is concerned only with realized losses, as with realized gains. *Weiss v. Wiener,* 279 U. S. 333, 335. Exception is made, however, in the case of losses which are so reasonably certain in fact and ascertainable in amount as to justify their deduc-

> tion, in certain circumstances, before they are absolutely realized. As respects losses occasioned by the taxpayer's breach of contract, no definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test. And the direction that net income be computed according to the method of accounting regularly employed by the taxpayer is expressly limited to cases where the Commissioner believes that the accounts clearly reflect the net income." (p. 449.)

Clearly the impounded funds constituted income. *Doyle v. Mitchell Bros. Co.,* 247 U. S. 179, 185, and *Eisner v. Macomber,* 252 U. S. 189, 207. And, in a proper case, they were returnable for taxation upon the basis upon which the taxpayer kept its accounts, if such basis clearly reflected the taxpayer's income. This is so under the provisions of Section 13(d) of the Acts of 1916 and 1917 (Act of Sept. 8, 1916, 39 Stat. 756, c. 463; Act of October 3, 1917, 40 Stat. 300, c. 63) which provides that,

> "A corporation * * * keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned; * * *."

The Commissioner's approved interpretation of section 13(d) was that it

> "will be permissible for corporations which accrue on their books monthly or at other stated periods amounts sufficient to meet fixed annual or other charges to deduct from their gross income the amounts so accrued, provided such accruals approximate as nearly as possible the actual liabilities for which the accruals are made, and provided that in cases wherein deductions are made on the accrual basis as hereinbefore indicated, income from fixed and determinable sources accruing to the corporations must be returned, for the purpose of the tax, on the same basis."

See *United States v. Anderson*, 269 U. S. 422, 437, 438, and also at page 440, where it is said that the purpose of sections 12(a) and 13(d) of the Act of 1916

> "was to enable taxpayers to keep their books and make their returns according to scientific accounting principles, by charging against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during that period; and indeed, to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strict receipts and disbursements basis."

The income represented by the sales of oil in 1916 and which was impounded in the hands of the receiver was from a "fixed and determinable" source, and it was definite in amount. It was in fact accrued upon the books of the Petitioner in the year 1916 and

by amended return for that year, filed in 1918, it was returned for taxation as the accrued income of the Petitioner. Neither the accruability of the income nor the propriety or legality of filing in 1918 the amended return for 1916 was questioned in any way by the Commissioner until 1927, when he affirmatively raised the question before the Board of Tax Appeals. (R. 122-123; R. 46-47; R. 139; and Petition herein p. 8.) At no time did the Petitioner for a moment admit that it was not entitled to Section 2 as against the Government. On the contrary, it contended always, and prevailed in the contention, that it was the equitable owner of Section 2 and, in consequence, of the money realized in 1916 from the sale of oil produced therefrom. This case on its facts is, therefore, the opposite of *Lucas v. American Code Company,* supra, where the taxpayer always denied liability; and it is clearly distinguishable from *Lucas v. North Texas Lumber Co.,* 281 U. S. 11 (cited by the Circuit Court of Appeals), which involved an executory contract to sell land, and in which it was said that a condition precedent had to be performed by the taxpayer before he could lay any claim to the purchase price.

In this case no "condition precedent" remained to be performed by the Petitioner at the date of the filing of the Government's suit to quiet title. All facts were then in existence which enabled the Petitioner to say that it was the equitable owner of the land and the impounded money. The decision of the Court created nothing; it merely declared what the facts meant.

The incident of the receivership should be disregarded as having no effect upon the situation. The receiver was a mere arm of the Court and was invested with no estate in Section 2. *Converse v. Hamilton,* 224 U. S. 243. He held for the Court for the benefit of whomsoever it should at the end of the suit be found to concern, and no rights or titles were changed by his possession. *Grant v. Mutual Life Insurance Co.,* 106 U. S. 429. Suppose, as Judge James supposed in *Obispo Oil Co. v. Welch, Collector,* 48 F. (2d) 872, 875, Southern District of California, that no receiver had been appointed, but that *pendente lite* in 1916 the Petitioner herein had operated Section 2, extracted and sold oil therefrom, but had not actually received the money therefor until 1917 although it had accrued it upon its books as income in 1916. Upon such a state of facts is there anything in the income-tax law which would have precluded the accrued item from being income taxable to the Petitioner in 1916 merely because the Government, the owner of the legal title to Section 2, was challenging by suit the Petitioner's equitable title to the section and to the income produced therefrom? Or suppose that the bill in equity had been filed by a third party and not by the Government. Is there anything in the income-tax law which would have precluded the Petitioner from accruing the item as income in 1916?

If the right to income must be unconditional to warrant its accrual, then it would seem to follow that any quiet title suit, however groundless, filed against the Petitioner herein at the present moment by anybody, however irresponsible, would prevent the Peti-

tioner from accruing upon its books income from the property involved in the suit. It would seem also that any challenge in a lawsuit of a right to income would prevent the income from being accrued. Such a result does not seem to be reasonable. And yet, as we understand the matter, the position of the Government in this case must be that the 1916 earned income was not accruable by the Petitioner for the reason that its right to that income was challenged in litigation instituted by the Government.

We submit that a practical view of the matter is to be taken (*Lucas v. American Code Company,* supra), and that in such a view a taxpayer who consistently keeps his accounts upon the accrual basis should, during litigation over the title to income producing property, continue to accrue the earnings as income, and to return them for taxation as accrued income, year by year as the moneys are "earned" from the property producing them, if the taxpayer was in possession of the property under color and claim of right at the time of the commencement of the suit, as was the case with the Petitioner, and litigates his right to a conclusion, either favorable or adverse to himself.

And on this aspect of the case it is submitted that it is material to know as a fact whether or not the Petitioner herein was upon the accrual or the cash basis in 1916. The fact about that matter was not found by the Board of Tax Appeals. It is true that on the Petitioner's tax returns for 1916 and 1917 the word "Yes" was written in answer to the question of whether the return was made "upon the basis of actual

receipts and disbursements." But there is also evidence in the record, as has been pointed out by both Petitioner and Respondent (R. 24, 67, 68, 72, 169, and 178) that the accounts were kept and the returns filed on the accrual basis. And "whether a return is made on the accrual basis, or on that of actual receipts and disbursements, is not determined by the label which the taxpayer chooses to place upon it." (*Aluminum Castings Company v. Routzahn,* 282 U. S. 92, 99.) The impounded funds issue was not asserted in the Commissioner's sixty-day letter. It was asserted as an affirmative defense in the Board proceedings and was not and is not clothed with any presumption of correctness. The burden was upon the Commissioner to prove that the taxpayer was not upon the accrual basis (*Brunton v. Commissioner,* 42 F. (2d) 81, 82), and he failed to carry it. If the basis upon which the Petitioner kept its accounts is material, as we submit is the case, the proceeding should be remanded to the Board of Tax Appeals for complete findings. Compare *Universal Battery Co. v. U. S.,* 281 U. S. 580, 584.

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## II.

**IF UNCONDITIONAL RIGHT TO INCOME, AND NOT CLAIM UNDER COLOR OF RIGHT, IS AT THE FOUNDATION OF THE RIGHT TO ACCRUE, THEN IT WOULD SEEM TO FOLLOW THAT UNCONDITIONAL RIGHT AND NOT MERE CLAIM OF RIGHT TO INCOME MUST EXIST TO RENDER IT TAXABLE AS CASH INCOME.**

If the Court should hold that the right to income must be unconditional to justify its accrual as in-

come for a given year, then it would seem to follow that the right to income must be unconditional to warrant or justify including the income in cash income upon the cash basis of accounting. Any basis of accounting is permitted under the income-tax laws in force since the Revenue Act of 1913, if it correctly reflects income. (*United States v. Anderson,* supra.) In the case at bar it cannot be doubted that the impounded funds were income—produced by capital, severed from the capital which produced them, and made available for use apart from that capital. (*Eisner v. Macomber,* supra.) The only question is as to the year in which the income is taxable; and the answer to this question does not turn upon the nature or character of the fund but upon the nature or character of the right to it. If this analysis is correct it would seem to follow irresistibly that upon either the accrual basis or the cash basis of accounting the nature or character of the right to income must be the same to justify its inclusion in the category of taxable income. And so, it would seem, if the right to income must be unconditional to warrant or justify the accrual of the income in a given year, then we submit that the right thereto must be of precisely the same character to warrant or justify the inclusion of the income as taxable income on the cash basis of accounting.

Assuming that the Petitioner was on the cash basis of accounting, if the above analysis is correct the mere fact that the Petitioner actually received the impounded funds in 1917, even under a claim of right thereto asserted at all times during the litigation, was

not enough to make the funds taxable cash income. The event (the dismissal of the litigation by the Supreme Court) which definitely determined the Petitioner's right to the funds did not happen until 1922, and it was not until then that the Petitioner's right to the funds became unconditional. This view of the situation is supported by two cases, *Kentucky & Indiana Railroad Co. v. Commissioner,* Circuit Court of Appeals for the Sixth Circuit, decided December 18, 1931, 54 F. (2d) 738, and *Brown v. Commissioner,* Circuit Court of Appeals for the First Circuit, decided December 17, 1931. (See Appendix B of **Memorandum for the Respondent** herein, where the opinion will be found.)

In the *Kentucky & Indiana Railroad Company* case, supra, the taxpayer contended that certain tolls collected by the Director General of Railroads on a bridge owned by the taxpayer company, were owned by the taxpayer company and in fact and for taxation were allocable to the federal control years, the taxpayer having kept its accounts upon the accrual basis. The dispute between the Government and the Company over the ownership of the tolls was settled by compromise in 1923. The Board of Tax Appeals decided that the tolls and interest thereon were taxable income in 1923, the year in which the taxpayer's right was definitely determined. The Circuit Court of Appeals said:

> "Petitioner, however, insists that the tolls having been collected in the federal control years and the interest having accrued during the same period these items for tax purposes should be allo-

cated to those years, instead of 1923, the petitioner having under the direction of the Interstate Commerce Commission kept its books upon the accrual basis. But the obstacle is that there was no acknowledgement or determination of liability on the part of the Government for either tolls or interest until the settlement in October, 1923. Petitioner made no demand for either tolls or interest during federal control. It did not place these items upon its books or return them as accrued income in the federal control years. This omission was not the result of oversight. It arose from the uncertainty petitioner entertained as to its duty to return the items for those years. This is significant inasmuch as the burden was upon petitioner to establish before the Board of Tax Appeals that the Commissioner should have allowed them for those years. See *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, 366. The tolls were omitted from the original claim presented to the Director General. Neither the tolls nor interest items became the subject of negotiations until June, 1923, when liability for each was vigorously disputed. We think that the event which definitely determined the Government's liability for either tolls or interest was the settlement in October following and that the taxable income in question arose then and not previously. See *Lucas v. American Code Co.*, 280 U. S. 445, 449; *Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115, 120; *Bauer Bros. Co. v. Commr.*, 46 Fed. (2d) 874, 876 (C. C. A. 6). These cases deal with expense rather than income items but the applicable principle is the same. See also *U. S. v. Anderson*, 269 U. S. 422, 441; *Burnet v. Sanford Brooks Co.*, supra. Until the settlement it could not be

known how petitioner would fare as a result of Government operation.

The decision of the Board of Tax Appeals is affirmed."

It is submitted that the principle applied in the *Kentucky & Indiana Railroad Company* case should be applied in the case at bar, certainly if the Petitioner was on the cash basis of accounting, unless that case is distinguishable on the ground that the railroad company made no claim to the tolls until after the federal control years, whereas the Petitioner herein always claimed the impounded funds. But such ground of distinction is, we submit, without substance if the Court should hold that the right to income must be unconditional to justify the accrual of income in a given year.

In the *Brown* case (see **Memorandum for the Respondent** herein), one of the questions was as to whether or not the profits of Brown & Adams "from handling the 1918 wool clip as licensed dealers under certain Government regulations was income received in 1918." The partnership of Brown & Adams kept its accounts on the accrual basis. During a part of 1918 and 1919 it did business as an approved dealer on a permit from the Wool Division of the War Industries Board under regulations providing that the partnership was entitled to compensation for distribution services in an amount equal to four per cent of the selling price and was required to dispose, as the Government decided, of all gross profits (including the 4% commission) in excess of 5 per cent of the

"season's business." In February, 1919, Brown & Adams set up an account entitled "Whom It May Concern," which was composed of the excess profits from the "season's business." The Commissioner refused to allow the entire amount of the excess profits as income in 1919, but divided it between 1918 and 1919. "A material amount" of the 1918 wool clip was not sold until 1919. At the end of 1918 the partnership entered on its books as its profits for 1918 5 per cent of the sales of wool in that year to eight accounts shown on its books. Further sales of the 1918 clip were made in 1919, and the eight accounts were closed. In computing the excess profits, the 5 per cent was subtracted from the net profits and the remainder, $253,254.77, was taken to represent the excess profits on the 1918 clip, whether the wool was sold in 1918 or 1919. Certain charges being disallowed the excess profits were increased to $268,947.16. The Government, in 1922, sued for the payment to it of the entire amount of excess profits so set up for 1918, but lost the suit. The partnership finally received as net profits in handling the 1918 clip more than $500,000, although in making their tax return for 1918 they reported but $229,655.67, that being the maximum amount they were entitled to retain under the regulations of the War Industries Board, calculated at 5 per cent of the gross sales. The Commissioner revised the taxable income by allocating to 1918 "that proportion of the total profits which gross sales for that year was of the gross sales for the entire season"—"spring to spring." Further revision was made with the result that the actual profit on the

wool for 1918 was determined to be $504,950.79. (See 18 B. T. A. at p. 862.)

The Board of Tax Appeals (18 B. T. A. at p. 866) reasoned that the excess profits were legally the income of the partnership in 1918, and says:

> "Our holding would be the same, even if full force were given to the wool regulations, for they in terms recognize rightful receipt of the profits by the partnership and purport only to control disposition thereafter. * * * A mere constraint on their disposition by reason of a possible future contingency does not reduce either gross or net income. * * * Since the wool regulations have been without force to take from petitioners any part of their profits, or to impose them with a trust for the Government, such profits must be regarded as having accrued to petitioners irrespective of the regulations or resulting litigation."

As to this the Circuit Court of Appeals held that the accrual as income of 1918 of 5 per cent of the profits on sales made on the 1918 clip, regardless of when the sales were made, was proper, but that the Commissioner was wrong in attempting to include in 1918 income the excess profits above 5 per cent. This holding, that the profits in excess of 5 per cent were not income in 1918, rests, we believe, upon the theory that the right to the excess profits had not become fixed and determined until the termination of the litigation in which the right to the excess profits was being challenged. If that is the basis of the decision, then the case supports and is not contra to the proposition that, in the case at bar, the Petitioner being on a cash

basis, the impounded funds were not taxable until 1922. And, of course, it seems to be clear that the *Brown* case is direct authority for the proposition that, the Petitioner being upon the accrual basis, in possession of Section 2 under the invitation extended by the mining laws of the United States, having made actual discovery thereon prior to the commencement of the Government's quiet title suit, and having continuously and at all times claimed the land and the production thereof, the income of 1916 was properly accruable in 1916, although it was subject to the contingency that the Government might win the suit.

It is accordingly submitted that, if the Petitioner was upon the cash basis of accounting, the mere receipt of the impounded funds in 1917 was not alone sufficient to subject them to taxation in that year. And unless it is to be presumed that the Petitioner herein kept its accounts upon the cash basis, this proceeding should be remanded to the Board of Tax Appeals for complete findings. *Universal Battery Co. v. U. S.*, supra.

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## III.

**NONE OF THE CASES RELIED ON BY THE CIRCUIT COURT OF APPEALS SUSTAINS THE POSITION OF THAT COURT THAT IRRESPECTIVE OF THE ACCOUNTING BASIS THE IMPOUNDED FUNDS ARE TAXABLE IN THE YEAR IN WHICH THEY WERE RECEIVED.**

When properly considered, we believe that *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, which is relied on by the Circuit Court of Appeals, does not stand for the principle that income is taxable when received

regardless of the accounting basis upon which the taxpayer keeps his books of account. In that case it appears that the Court did not hold, nor did Sanford & Brooks Company assert, that the taxpayer had ever filed returns in compliance with the regulations or Section 212 (b) of the Revenue Act of 1918 (p. 366). The taxpayer's contention was, not that the money awarded by the judgment of 1920 was taxable income in some specified year, but that it was not taxable income in any view for the reason that the net profit contemplated by the statute as taxable "can only be net profit ascertained on the basis of particular transactions of the taxpayer when they are brought to a conclusion" (p. 363). In other words, the taxpayer's contention was that inasmuch as its dredging job did not yield a net profit when considered as a whole, there was nothing to return for taxation in any year. The Court held, however, that the revenue act taxes annually the net income resulting from all transactions within the tax year and that income derived from any source within the tax year must be included in the gross income of that year. It is true that the Court said (p. 363) "the recovery made by respondent in 1920 was gross income for that year." And it is also true that it was in that year, 1920, that the right of the taxpayer to the income became fixed and determined. Inasmuch as it does not appear whether the taxpayer was on the accrual or the cash basis, and inasmuch as it does appear that the taxpayer's right to the income became fixed and determined in 1920, the *Sanford & Brooks Company* case does not appear to support the view of the Circuit Court of Appeals

herein that income is taxable when actually received irrespective of the basis upon which a taxpayer keeps its books of account. Rather, it directly supports the Petitioner's contention that, as to a taxpayer on he cash basis of accounting, income though actually received cannot be taxable until the right thereto becomes fixed and determined.

So far as the *Sanford & Brooks Company* case dealt with amended returns it indicated that they should be rejected because there was upon the facts of that case no basis for offsetting the income received in 1920, when the right to it had become fixed and determined, against the losses sustained under the dredging contract in 1913, 1915, and 1916, the income being returnable on the basis of fixed accounting periods and the company having failed to exercise its option to make its tax returns on the long term basis. But in neither the case at bar nor the *Sanford & Brooks* case was it a question of whether or not the amended return was based on hindsight. Clearly in the case at bar the question is whether or not the income can be properly reported on the basis set forth in the amended return.

To the point that income "is ordinarily taxable only when it is received" the Circuit Court of Appeals cites and relies on (R. 203) *Herold v. Mutual Benefit Life Ins. Co.*, 201 Fed. 918; *Maryland Casualty Co. v. U. S.*, 251 U. S. 342; *Eisner v. Macomber*, 252 U. S. 189, 207; *Eckert v. Burnet*, 283 U. S. 140; *Lucas v. North Texas Lumber Company*, 281 U. S. 11; and *Commissioner v. Garber* (C. C. A. 9), 50 F. (2d) 588; but

it seem that none of these cases is in point on the precise question involved in the case at bar.

The *Herold* and *Maryland Casualty Company* cases arose under the Excise Tax Act of 1913, and it was held in the first that tax returns under the 1909 Act should be made on the cash receipts basis, and in the second that both the 1909 and 1913 Acts are based on the receipts and disbursements theory and tax returns thereunder must be made on the cash receipts basis. As pointed out in *United States v. Anderson*, 269 U. S. 422 (see page 439), Section 13(d) of the Revenue Act of 1916 which provides for return upon the basis upon which the taxpayer's accounts are kept, if it clearly reflect income, "did not have its counterpart in earlier legislation." Moreover, neither of the cases dealt with the question of the nature or character of the right to income which permits it to be accrued and taxed in a given year or which permits it to be entered as a cash receipt and taxed in the year of its receipt.

*Eisner v. Macomber*, supra, the stock dividend case which arose under the Revenue Act of 1916, 39 Stat. 756, c. 463, did not pass upon the questions involved in the first and second points argued in this memorandum. It is, of course, true that the majority of the Court said that gain or profit must be "received or *drawn by* the recipient (the taxpayer) for his separate use, benefit and disposal" to answer the description of income. (See p. 207.) But that was said in the particular circumstances of that case. Moreover, if the words are to be understood literally they

support the Petitioner's second point herein, that in this case the mere receipt of the impounded funds in 1917 did not render them taxable cash income for that year for the reason that the right to them did not become fixed and determined until 1922 when the litigation over that right was terminated.

The case of *Eckert v. Burnet,* supra, concerns a taxpayer who claimed a deduction from income of $22,400 as a bad debt. He made his tax return on the cash basis. (p. 141.) He had been liable as endorser of the promissory note of an insolvent maker, and he substituted his own note for the one which he had endorsed and then marked the endorsed note paid. It was held that the taxpayer was not entitled to deduct the amount of the endorsed note as a debt "ascertained to be worthless and charged off within the taxable year," for the reason that it was not definitely ascertained in 1925, the year of the transaction, that the taxpayer would sustain the loss in question. In other words, to express the matter in the terms we have been using in this case, the taxpayer's loss had not become fixed and determined in 1925. It did not become fixed and determined until he paid the note.

*Lucas v. North Texas Lumber Co.,* 281 U. S. 11, has already been mentioned above. It dealt with an executory contract for the sale of land which could not have become an executed contract until the taxpayer had prepared the papers which were necessary to enable it "to effect the transfer or make tender of

title or possession or demand the purchase price in 1916," and therefore the accrual of the purchase price as income in 1916 was not permitted. The case seems to stand not for the proposition that income is ordinarily taxable when received, but for the proposition that, as to a taxpayer upon the accrual basis, money cannot be accrued as income until the right to it has become fixed and determined.

In the case of *Commissioner v. Garber* (C. C. A. 9), 50 F. (2d) 588, it appears that the taxpayer and certain associates had sold oil and gas leases to the Garfield Oil Company for 200 shares of that company's stock of the par value of $20,000. The 200 shares were half of the company's outstanding stock, and of them the taxpayer received 75 shares. In December, 1918, the taxpayer and his associates entered into two contracts as to which the Circuit Court of Appeals said (p. 589):

> "Taken together, and construed in the light of the negotiations that preceded their execution, the contracts clearly establish that the entire purchase price to be paid to Garber (the taxpayer) and his associates for their Garfield leases was to be $3,000,000. Of this amount $500,000 was paid in cash by the Exchange Oil Company, a subsidiary of the Sinclair Company, and the balance was to be paid out of the income from the certificates, with the ultimate guaranty of outright purchase by the Sinclair Company, on December 14, 1923, of the 200 oil and gas certificates."

The $500,000 was paid in cash in December, 1918, and the balance of the purchase price of $3,000,000 was paid out of the receipts from the certificates.

As stated by the Circuit Court of Appeals (p. 589), "the controlling question of law presented in this case is whether or not the 'income' derived from the sale of the Garfield oil stock, under the two foregoing agreements of December 14, 1918, was income taxable in its entirety in 1918, or was distributable according to the sums received from the certificates during the intervening years, up to and including 1923." The Commissioner contended that "the tax became due as the various payments were received, from year to year." The taxpayer computed his income and filed his returns for 1918 to 1923, inclusive, upon the cash receipts basis and claimed deductions for depletion, which were disallowed by the Commissioner. But in 1925, the statute of limitations having then run against a reassessment by the Government, the taxpayer filed an amended return for 1918 in which he claimed that the "profits from the sale of the taxpayer's interest in 75 shares of the capital stock of the Garfield Oil Company was income for the calendar year 1918, and not for 1919," and that the Commissioner erroneously included said income in the year 1919.

Inasmuch as the taxpayer was on the cash receipts basis, the Court held that he could not accrue in 1918 the profit derived from the sale of his stock, the payments therefor having been made year by year. This

view, says the Court (p. 591), "precludes the possibility of a sudden change of theory after the statute of limitations has run."

We do not see that this *Garber* case militates against any position thus far advanced by the Petitioner in the case at bar. The North American Oil Consolidated accrued the impounded funds upon its books as income for 1916 and it filed its amended return for 1916 long before any statute of limitations had run against the right of the Government to reassess for 1916. There was, therefore, no "sudden change of theory after the statute of limitations has run."† Moreover, it appears in the *Garber* case that the right of the taxpayer to the money representing his profit on the sale of his oil leases was at all times fixed and determined. And so the *Garber* case does not seem to be contra to the second point advanced in this memorandum by the Petitioner herein.

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## CONCLUSION.

It is submitted (1) that if the basis of accounting is material to a decision herein, this case should be remanded to the Board of Tax Appeals for findings upon that issue; and (2) that if it is to be presumed that the Petitioner was upon the cash basis of accounting, the impounded funds did not become tax-

†At the earliest the bar of the statute of limitations would have fallen in 1921. See section 1322, Revenue Act of 1921, Act of November 23, 1921, 42 Stat., c. 136. The amended return, together with a letter of explanation, was filed March, 1918, (R. 122) and a revenue agent made an examination of Petitioner's books in 1920 (R. 123).

able income by virtue merely of their receipt, but that they were not taxable income until the Petitioner's right to them had been finally fixed and determined.

Dated, San Francisco, California,
March 5, 1932.

Respectfully submitted,

HERBERT W. CLARK,
*Attorney for Petitioner.*

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No. 575

# In the Supreme Court of the United States

OCTOBER TERM, 1931

NORTH AMERICAN OIL CONSOLIDATED, A CORPORATION, PETITIONER

*v.*

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.*

## MEMORANDUM FOR THE RESPONDENT

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# In the Supreme Court of the United States

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NORTH AMERICAN OIL CONSOLIDATED, A CORPORATION, petitioner

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## MEMORANDUM FOR THE RESPONDENT

The respondent does not oppose a limited review in this case.

### OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 130–145) is reported in 12 B. T. A. 68. The amended opinion of the Circuit Court of Appeals (R. 194–203) is reported in 50 F. (2d) 752.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 15, 1931. (R. 193–194.) Peti-

tion for rehearing was filed July 15, 1931, and was denied September 14, 1931. (R. 194.) Petition for a writ of certiorari was filed December 14, 1931. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

## QUESTIONS PRESENTED

1. Whether under Section 13(c) of the Revenue Act of 1916 it was the duty of the receiver of a part of the property or business of a corporation to file an income-tax return in respect of such part of the property or business.

2. Whether income received by such receiver was income taxable in the year in which he received it or in a later year when by court order he turned it over to the corporation.

## STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in Appendix A, *infra*, pp. 13–17.

## STATEMENT

The petitioner is a California corporation. During the years involved it was engaged in producing oil and derived income from oil wells on many parcels of land. (R. 92–111.) On July 15, 1913, the petitioner acquired by purchase a parcel of land described as Section 2, Township 32, Range 23 East M. D. B. & M., Kern County, California. (R. 116.)

Prior to November 30, 1915, suit was instituted by the United States in the United States District

Court for the Southern District of California to oust the petitioner from possession of this property, and on February 3, 1916, the Court entered an order appointing a receiver to operate or supervise the operation of the oil wells on this property and to receive the income arising therefrom. (R. 116–120.)

On June 5, 1917, the order appointing the receiver was vacated by final decree of the District Court (R. 120) and the bill was dismissed (242 Fed. 723). The government appealed and the Circuit Court of Appeals affirmed the decree of the lower court. (264 Fed. 336.) The case was brought to this Court where the appeal was dismissed under a stipulation of counsel. (258 U. S. 633.) See mandate of March 21, 1922. (R. 120–122.) On April 12, 1922, a patent to Section 2 was issued by the United States to certain applicants who had agreed to convey to the petitioner.

During the period February 2, 1916, to December 31, 1916, the receiver collected and impounded net income from the oil wells on the property amounting to $171,979.22. (R. 123.) This income had been entered on the books of the petitioner as its income and was reported in its amended return for that year. (R. 122.) It was actually turned over to the petitioner in June, 1917, at the time of the District Court's decree. (R. 123.)

Upon auditing the petitioner's income and profits tax returns for 1917, the Commissioner deter-

mined a deficiency of $109,239.61, the deficiency being based on other items. The petitioner appealed to the Board of Tax Appeals. In an amended answer to the amended petition filed January 29, 1927, the Commissioner prayed that the deficiency for 1917 be increased to $253,150.96 to include the tax on the income of $171,979.22 paid over by the receiver in that year. (R. 45–48.)

The Board of Tax Appeals held that the sum in question was not taxable to the petitioner in 1917 but was taxable to the receiver in 1916 irrespective of whether the petitioner was on the accrual basis or on the cash receipts and disbursements basis and found a deficiency of only $35,806.30. (R. 145–146.)

Upon appeal to the Circuit Court of Appeals for the Ninth Circuit that court reversed the decision of the Board, holding that the receiver, as a receiver of less than all of the property of the petitioner, was not required to file a return in its behalf for 1916, and that the income was taxable to the petitioner for 1917. (R. 194–203.)

## ARGUMENT

The decision below first dealt with the question as to whether Section 13 (c) of the Revenue Act of 1916, requiring receivers operating the property or business of corporations to make returns of net income as and for such corporations, applied in circumstaces like those of this case where the receiver was the receiver of a part only of the property or business of the petitioner, and the holding was

that Section 13 (c) did not so apply and accordingly the receiver was not required to file a return. The court then considered whether the income in question was income of the corporation in the year 1916, when it was received by the receiver, or in the year 1917, when, by court order, the receiver was directed to turn over such income to the corporation, and the decision was that such income was not taxable to the petitioner in the year 1916.

In so far as the petition for certiorari involves the question whether the court below correctly decided that the income was taxable to the corporation for 1917, we do not oppose the petition. Since the petition was filed in this case, the Circuit Court of Appeals for the First Circuit has decided a closely analogous question in a way which, if it does not establish a principle directly in conflict with the decision in the case at bar, at least creates great confusion as to the principle for which each case may be said to stand. See *Commissioner* v. *Brown*, 18 B. T. A. 859, decided by the Circuit Court of Appeals December 17, 1931, but not yet reported. (Portions of such opinion are printed in Appendix B.)

In the *Brown* case, during 1918 and 1919 a partnership was a licensed wool dealer under certain governmental regulations which required it to set aside on its books all amounts received in excess of 5% of the gross profits on the season's business, with the understanding that such excess would ulti-

mately be returned to the growers in such manner as the Government should decide. Litigation ensued between the government and the partnership as to the ownership of the excess profits which was not terminated until 1930, when a final decision was rendered for the taxpayer. The court decided that the excess profits were not accrued income of the taxpayer for 1918, when payments for the wool were received, but only when the controversy as to the partnership's ownership thereof had been determined in its favor.

It will be noted that in the *Brown* case the Board of Tax Appeals definitely found that the taxpayer was on an accrual basis, whereas in the instant case no finding was made as to whether the petitioner kept its books and rendered its return on the cash receipts and disbursements basis or on an accrual basis, and that the court attributed no significance to the accounting method employed (R. 201), but held that, irrespective of the method employed, the income was taxable to the corporation for 1917 when the receiver was discharged. The returns themselves indicate that they were filed on the cash basis (R. 169, 178), but there is some slight evidence to the contrary (R. 24, 67, 68, 72). In view, therefore, of the court's decision that the income in this case would be taxable for 1917, irrespective of the basis of filing the returns, it can not be said that the instant case is so clearly distinguishable from the decision in the *Brown* case that the exercise of the supervisory power of this Court is unnecessary.

The extent to which each should be accepted as authority is uncertain. We believe that the decision in the *Brown* case is clearly wrong and the propriety of filing of a petition for a writ of certiorari in that case is under consideration.

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As to the first point considered by the court below, i. e., the applicability of Section 13 (c) of the Revenue Act of 1916 to the receiver in this case, we submit that the holding below is correct, that the income received by the receiver in 1916, and returned to petitioner by court order in 1917, was properly taxable to the corporation and not to the receiver.

Sections 10 and 13 (a) of the Revenue Act of 1916, *infra,* require every corporation to file a return of gross income and deductions and to pay a tax on its net income from all sources disclosed by this return.

The petitioner contends that it was relieved of the necessity of reporting the income held by the receiver in 1916 because that duty was placed upon the receiver by Section 13 (c) of the Revenue Act of 1916, *infra,* which provides:

> In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as

> and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control.

This provision was not changed in the amendments of the Revenue Act of 1916 made by the Revenue Act of 1917.

The Circuit Court of Appeals held—correctly, we submit—that this provision did not apply to a receiver operating only a part of the property of the petitioner.

The statute refers to receivers, trustees in bankruptcy, or assignees who "are operating the property or business of corporations * * *." The use of the word "the" in this phrase plainly means that it is only where the receiver is in charge of all of the property or business of a corporation that he is required to make a return of income in behalf of the corporation. This conclusion is fortified by the fact that the trustee or receiver is required to make returns of net income "as and for such corporations" and the tax due thereon is to be assessed and collected "in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and con-

trol." Thus only where the receiver is in entire charge of the property or business of the corporation is he substituted for the corporation and becomes liable for tax in its stead. See *Reinecke* v. *Gardner,* 277 U. S. 239. Further, the regulations of the Treasury Department have consistently construed the provisions of the various statutes relating to receivers, whether of individuals or corporations, as applying exclusively to those in complete charge of the business or property of the taxpayer. While Articles 26 and 209 of Regulations 33, *infra,* do not specifically mention receivers in charge of part of the property or business, by reference to receivers standing in the stead of their principals in the case of individuals and to the suspension of powers in the case of corporations it seems perfectly clear that receivers of the former class are excluded.

Articles 424 and 622 of Regulations 45, *infra,* embody the same rule in more specific language. True, Articles 424 and 622 of Regulations 45 were promulgated under the Revenue Act of 1918, Section 225 of which specifically exempts from the requirement of filing returns receivers in possession of part only of the property of an individual; but notwithstanding that, Section 239 of that statute made no corresponding change as to receivers of corporations and the Treasury Department made the same regulations as to both and did not change them in substance from what they had been under the Revenue Act of 1916.

To the same effect are Articles 424 and 622 of Regulations 62, 65, and 69 and Article 392 of Regulations 74.

This settled administrative construction is entitled to great weight, particularly since Congress during the period that the regulations were in effect repeatedly reenacted provisions relating to receivers,[1] which, in so far as corporations were concerned, were identical in all material respects with Section 13 (c) of the Revenue Act of 1916. *Brewster* v. *Gage*, 280 U. S. 327, 336; *National Lead Co.* v. *United States*, 252 U. S. 140, 145–146. If the departmental construction of Section 13 (c) of the Revenue Act of 1916 had been deemed incorrect, Congress would no doubt have changed the law in the revisions of 1918, 1921, 1924 or 1926. See *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232, 235.

The regulations were obviously reasonable. To hold that a receiver such as the receiver in this case should return a part of the income of a corporation, and that the corporation should return the balance, would in many instances give a corporation so situated an undue advantage as to credits allowed in computing the tax (see, for example, Sections 202 and 203 of the Revenue Act of 1917,

[1] See Section 239 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1081; Section 239 (a) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 259; Section 239 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 287 (U. S. C., Title 26, Section 991); Section 239 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 45 (U. S. C. App., Title 26, Section 991).

c. 63, 40 Stat. 300), and as to the allocation of income in the different brackets on which different rates of profits taxes are imposed (see, for example, Section 201 of the Revenue Act of 1917). There is no provision in the Act for the consolidation of the return of the receiver of part of a corporation's property and the return of the corporation itself.

The case of *Forstmann* v. *Ferguson*, 17 F (2d) 659, affirmed (C. C. A. 3rd), 25 F. (2d) 47, is not *contra*. That case did not involve any consideration of the duty of a receiver or trustee in bankruptcy to file returns, but dealt only with the duty in that respect of a fiduciary, under Section 219 of the Revenue Act of 1918. It was there held that where a corporation had been directed by court order to refrain from paying dividends on stock which had been seized by the Alien Property Custodian, the corporation should file a fiduciary return as trustee with respect to such dividends.

## CONCLUSION

We do not oppose the granting of the petition, but we suggest that the writ should confine the question to be considered by this Court to the single question as to the year in which the income was taxable. We submit that the decision below correctly decides that Section 13 (c) of the Revenue Act of 1916 does not apply to receivers operating a part of the business of corporations, and that so much of the petition as relates to that should be denied.

As to the latter question there is no conflict of decision and the question presented is not of general importance.

Respectfully submitted.

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JANUARY, 1932.

## APPENDIX A

Revenue Act of 1916, c. 463, 39 Stat. 756:

SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income; * * *

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources— * * *

SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first: * * *

* * * * *

(c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such

organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control; * * *.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1074, 1081:

SEC. 225. That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a nonresident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same is, to the best of his knowledge and belief, true and correct.

SEC. 239. That every corporation subject to taxation under this title and every per-

sonal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

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Treasury Regulations 33:

ART. 26. * * *

RULINGS ON MAKING RETURNS

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181. Receivers who, as officers of a court, stand in the stead of some principle are required to account for income tax as the principal would have been required to account.

* * * * *

ART. 209. *Receivers to make returns.*—Section 13, paragraph C, of this title requires receivers, trustees in bankruptcy, or assignees, who are in charge of and are operating the property and business of corporations, to make returns of annual net in-

come and pay any income tax thereby shown to be due, regardless of what disposition, subject to the orders of the court, may be made of such income.[1]

Notwithstanding the fact that the powers and functions of the corporation are suspended and that the property and business are for the time in control and custody of the receiver, trustee, or assignee, subject to the orders of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required for the purpose of this title to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. The income which he receives on account of the business transacted is the income of the corporation and, no matter how such income is applied, it is subject to the tax imposed by this title in so far as it exceeds the deductions or allowances authorized by law.

The receiver, trustee, or assignee acting for the corporation, is required to make a true and accurate return of annual net income covering each year or part of each year during which he is in custody and control of the business or properties and will be liable to all the penalties imposed by this title for failure to meet any of its requirements.

Treasury Regulations 45:

ART. 424. *Return by receiver.*—A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on form 1040 (revised) or 1040 A (revised).

When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be made as if by the corporation itself. See section 239 of the statute and article 622. A receiver in charge of the business of a partnership shall render a return on form 1065 (revised). A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common-law receivers of all the property or business of an individual or corporation must make returns. See also section 256 of the statute and articles 1071–1080.

ART. 622. *Returns by receivers.*—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on form 1120, covering each year or part of a year during which they are in control. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. See articles 424 and 547.

## Appendix B

United States Circuit Court of Appeals for the First Circuit. October term, 1931. No. 2578. *Commissioner of Internal Revenue, petitioner for review,* v. *Jacob F. Brown.* No. 2583. *Jacob F. Brown, petitioner for review,* v. *Commissioner of Internal Revenue.* Appeals from Board of Tax Appeals. Before Bingham, Wilson, and Morris, *J. J.* Opinion of the Court. December 17, 1931.

Wilson, *J.*: These are petitions for review of decisions of the Board of Tax Appeals affirming in part a decision of the Commissioner of Internal Revenue assessing the income tax of the partners of Brown & Adams, wool dealers in the city of Boston, for the calendar year of 1918, and overruling the Commissioner in refusing to allow as a deduction to Jacob F. Brown in 1918 the cost of certain Japanese bonds sequestered by the German government during the war as alien enemy property.

The partnership of Brown & Adams was composed of six co-partners, each of whom is a petitioner for review, but by stipulation the tax of the other five co-partners are to be determined by the decision in the case of Jacob F. Brown, petitioner.

The two cases involve three main issues, first, whether the profits from handling the 1918 wool clip as licensed dealers under certain government regulations was income received in 1918; second, whether certain contingent charges made in 1918

for financing a textile corporation of which the partnership was a creditor was income in 1918; and, third, whether certain Japanese bonds belonging to Jacob F. Brown, on being sequestered by the German government in 1918, could properly be treated as a loss within the meaning of Sec. 214 (a) (5) of the Act of 1918.

WOOL PROFITS

With reference to the issues raised by the profits from handling the wool clip of 1918, the Board of Tax Appeals found the following facts:

> The partnership kept its accounts in accordance with an accrual method. During a part of the years 1918 and 1919 the partnership did business as an approved dealer on a permit issued by the Wool Division of the War Industries Board, as provided in the Board's Regulations of May 21, 1918, said regulations providing among other things that the Government should have a prior right to acquire all of the 1918 wool clip at prices to be officially fixed, plus 4 percent of the selling price as compensation for distribution services, and that the approved dealers should sign an agreement that their books would at all times be open to Government inspection, that they would operate subject to the Board's rules, and if at the end of the season it should be found that their gross profits (including the commission) were in excess of 5 per cent of the "season's business," then such gross profits should be disposed of as the Government decided.
>
> Upon dissolution of the War Industries Board, December 31, 1918, its powers and

functions, including those relating to payments required by regulations affecting the wool clip, were transferred by presidential order to the Bureau of Markets, Department of Agriculture, which on May 20, 1919, announced that the excess profits would be returned to the growers, and expressly prohibited the dealer from undertaking to make any adjustment with the grower, "no disposition of any excess profits" being authorized until such time as written instructions were given by the chief of the Bureau of Markets.

The wool clip of 1918, affected by the regulations, referred to wool grown and clipped in that year. Clipping is done from February to the middle of June and the "season's business" is from spring to spring, the dealer making purchases in the spring for a twelve months' supply, which is ordinarily sold or delivered by the following March or April.

Brown & Adams made substantial purchases of the 1918 wool clip, not all of which was sold and delivered until April, 1919. The partnership's journal entries of September, 1919, show sales of this clip under eight accounts, which had not closed at the end of 1918, there being a material amount of the wool then unsold. Although the partnership used the inventory method to compute the 1918 profits on wool not here in controversy, it took no inventories of the 1918 wool clip. Data from which such inventories could have been made have been continuously available.

At the end of 1918 the partnership noted the amount of wool which it had billed to the Quartermaster Corps, entering on its books as its profits for 1918 5 percent of such

business in that year. Further sales of the 1918 clip were made in 1919, and after the eight accounts were closed a new account entitled "Whom It May Concern" was set up February 24, 1919, composed of the excess profits in the eight accounts from the "season's business." In computing these excess profits, the 5 percent profit allowed by the Government's regulations were subtracted from the net profits and the total of the resulting differences, $253,254.77, was taken to represent the excess profits on the 1918 clip, no matter when sold. The account was set up pursuant to a request from the Bureau of Markets for information concerning the firm's disposition of all wool bought of the clip of 1918. Government auditors later disallowed certain charges taken in connection with the sales, and the account was increased, December, 1919, to $268,947.16.

Representatives of the War Industries Board orally and later by letters dated December 8 and December 20, 1919, made formal demand upon the partnership for immediate payment of these excess profits. The partnership did not comply, petitioner Brown advising the Government representative that he regarded the *pro rata* distribution, contemplated by the Government, of the excess profits to the growers as unfair, since some had received 65 cents and some 70 cents a pound for their wool. Brown offered to go over all the partnership's accounts with the individual growers and check up the grading of the wools and the prices realized, and, after working out the amount to which each grower was entitled, to send the Government the partnership's check for "Whom It May Concern" account.

The Government representative refused to agree to this method.

The "Whom It May Concern" account was thereafter taken out of the partnership's books, but later reinstated, being charged back to the partners. The Commissioner refused to regard the entire amount of these excess profits as income in 1919, but divided it between 1918 and 1919, segregating between the two years an amount of $301,922, made up of the $268,947.16 aforesaid, and about $33,000 credited from the interest account to profit and loss. This segregation was made by allocating to 1918 that proportion of the total profits which gross sales for that year was of gross sales for the entire season. The absence of inventories of the "restricted wool" was given in the agent's report as the reason for this method of allocation.

On June 2, 1922, the United States filed a suit in the district court for the District of Massachusetts against Jacob F. Brown et al., doing business under the firm name of Brown & Adams, for payment to the plaintiff of $295,051.63 with interest, alleging that defendants became bound to pay plaintiff said sum as excess profits on wool handled by them in 1918 by virtue of the aforesaid Government regulations and the defendant's agreement to operate subject thereto. The difference between the amount of the liability as set up on its books by the partnership and the amount for which the Government has brought suit is due to the exclusion by the Bureau of Markets of certain items of cost used by the partnership in computing the excess profits.

If all the wool had been consigned to the dealers under government regulations it would have elim-

inated any excess profits, but the wool growers in general refused to consign their wool to the dealers and trust to the government grading and possible delay in receiving their money. They preferred cash when their wool was delivered to a dealer or the usual terms of payment. The dealers in the majority of cases proceeded to handle the purchase and collection of the wool as usual, paying the grower whatever price could be agreed upon. The dealers then collected and stored and delivered the graded wool on Quartermaster's orders and at the price fixed by the government. To protect themselves against government grading and the expense of scouring, shipment, and storage, the dealers made the best bargains they could with the growers. In consequence Brown & Adams on the 1918 clip netted a considerable sum in excess of the 5 per cent profit allowed under the regulations of the Board.

In making up their income tax return for 1918, the partners reported as income from handling the 1918 wool clip their proportionate shares of 5 per cent of the gross sales to the government during that year, or $229,655.67, that being the maximum amount a dealer was allowed to retain under the Regulations of the War Industries Board for his services or profits as an approved dealer.

As a matter of fact the partnership finally received as net profits in handling the wool clip of 1918 over $500,000. Of the wool thus handled by Brown & Adams only a small amount, seven or eight per cent, was left for disposal in 1919, but the entire profits of the partners were not determinable until 1919.

The partnership, however, on the theory that it was not entitled to any profits over the 5 per cent

on its gross sales, but must return any excess profits to the government to be returned to the growers of whom it purchased the wool, in good faith carried in 1919 the excess profits to an account entitled "Whom It May Concern."

In 1919, as the Board found, the government made a demand on the partnership for the amount of these excess profits. The partners on learning of the manner in which the government proposed to distribute this sum, was advised by counsel that it was illegal and might involve them in litigation with the growers, and that it could not be equitably distributed in the manner proposed by the government for reasons set forth in *United States* v. *McFarland*, 15 Fed. (2d) 823, and *United States* v. *Brown*, 39 Fed. (2d) 851, which it is unnecessary to repeat here. The partnership thereupon refused to pay to the government the amount it had carried to the account of "Whom It May Concern" until it was determined who was entitled to it, or some equitable method could be devised for its distribution among the growers from whom the partnership had purchased the wool.

The action brought by the government in 1922 to recover of the partnership such excess profits was decided against the government in 1930; *United States* v. *Brown, supra.*

The Commissioner in assessing the deficiency tax for 1918 held, and his decision was affirmed by the Board of Tax Appeals, that having received in 1918 under his method of allocation this additional sum of approximately $270,000 as profits from the sale of the 1918 wool clip, it constituted income during that year, notwithstanding at that time the partnership made no claim to it, and until settled by the

suit in 1930, the government insisted that the partnership was not entitled to retain it.

The petitioner, however, now not only contends that the profits received by the partnership in excess of 5 per cent should not be treated as taxable income until the right to it was determined, but also further contends, notwithstanding the partners returned as income in 1918 5 per cent on its gross sales of wool to the government during that year, that they should not be charged with any income at all in 1918 resulting from the sale of the 1918 wool clip; that the handling of this wool clip should be treated as a single transaction, and as the wool season extends from April to April, and the partnership had not on December 31st, 1918, received from the sale of the wool clip of that year the total cost and expenses of handling the entire clip—though as a matter of fact the difference was small—no profits resulted until the cost of the wool and expense of handling had been met, which did not occur until 1919, and therefore he should not be taxed for any income from this source until 1919.

We think the partners were right in including in their tax returns for 1918 their proportional part of the sum represented by 5 per cent of the gross sales to the government for that year, and their present contention in this particular can not be sustained. The profits during the year 1918 of 5 per cent allowed by the government regulations on the gross sales were readily determinable at the end of the year, and as it was highly improbable that the remainder of the wool on hand January 1st, 1919, whether taken by the government or not, would fail to net the partnership sufficient to cover the balance of the cost and expenses of handling,

there was not sufficient ground for postponing the determination of their profits of 5 per cent until the entire 1918 wool clip handled by them was sold, especially since it appears from the record in the case that there was a marked improvement in the wool textile industry in 1919. We think ordinary business judgment would approve the course adopted by the partners in their 1918 return, since their books were kept on an accrual basis.

But we think the government was not entitled to have included in the 1918 return of the partners as income the excess profits above 5 per cent which the government insisted up to 1930 that the partnership had no right to retain, and to which the partners at that time made no claim, but themselves proposed in 1919 a plan of distributing it among the growers of whom the wool had been purchased and to whom the partners then claimed the excess belonged, and in which plan of distribution they offered to cooperate with the government.

The defense of the action brought by the government does not estop the partners from contending that the profits in excess of 5 per cent were not income received in 1918. The partners had contended that the government had no right to recover them to be disposed of in the manner proposed, even though the partnership had no right to retain them, and, further, that by reason of the invalidity of the Regulations, the government had no right to direct their disposition for any purpose. The petitioner was obliged to defend the action as well as the claim that the excess profits were taxable as income, or take the risk of being compelled to pay a judgment for the full amount as well as the

amount of the income tax on the same, if he acceded to the assessment by the Commissioner.

On the other hand, as the court said in *R. Hoe & Co.* v. *Commissioner,* 30 Fed. (2d) 630, 633: "It is hard to see why one department of the government could not bind another as to the extent of this loss." There appears to be no good reason why the same reasoning does not apply to gains as well as losses. The Bureau of Markets representing the executive department having set up the claim that the excess profits did not belong to the partners, "it is hard to see," as the court said in the above case, how such excess profits could consistently be treated as income for another branch of the executive department.

On this branch of the case the decisions in *Frederick McLean Bugher et al.,* 9 B. T. A. 1155; *McMurray* v. *Reynolds,* 38 Fed. (2d) 480, 482; *Peninsula Shipbuilding Co.,* 9 B. T. A. 189, 203; *Ansco Photo Products, Inc.* v. *Clark,* 34 Fed. (2d) 569; *Sanford & Brooks Co.,* 11 B. T. A. 452, affirmed 282 U. S. 359, 568; *Thorne Neale & Co., Inc.,* 13 B. T. A. 490, 495; *Northwestern Improvement Co.* v. *Commissioner,* 14 B. T. A. 79, 86; *Great Northern Railway Co.,* 8 B. T. A. 225, 269, support the petitioner's contention if they are not controlling.

In the last case cited, the Board of Tax Appeals said:

> Under either method (that is, cash or accrual) the taxpayer must have before him some definitely ascertained item of income to record before it can be reported and if a given transaction does not correspond to the definition of income then there is no income to record whether the taxpayer keeps its books on a cash or an accrual basis.

> Where books are kept on an accrual basis there is no requirement that there shall be accrued as income that which may never be received.

It is equally true, we think, that a taxpayer is not required to report as accrued income that which he may never be permitted to retain, because his right to it has not been determined, since "generally speaking, the income-tax law is concerned only with realized gains." *Burnet* v. *Logan*, 283 U. S. 404, 413; *Lucas* v. *American Code Co.*, 280 U. S. 445, 449.

Again in *Peninsula Shipbuilding Co.*, 9 B. T. A. 189, 203, the Board said:

> We will consider first the question whether claims made by the petitioner against the Emergency Fleet Corporation for depreciation as an element in determining the cost of the vessels built during the taxable year were accruable items. In numerous appeals the Board has held that disputed and contested claims not set up on the books of account of taxpayers are not accruable items of income or deductions therefrom until the year of actual settlement.

In *McMurray* v. *Reynolds*, 38 Fed. (2d) 480, 482, the court held:

> Whatever the rule is in regard to what constitutes income, I think it should be determinable upon the conditions and the circumstances which surround the transaction immediately at the close of the taxable year. If it then is determinable as income, it is likewise taxable; if it is not then determinable as income, it is not taxable, and can not, on account of conditions growing out of future contingencies, be made taxable.

* * * * *

*In No. 2578, decision of the Board of Tax Appeals is affirmed.*

*In No. 2583, the decision of the Board of Tax Appeals is reversed and the case is remanded to that Board for further proceedings not inconsistent with this opinion.*

U. S. GOVERNMENT PRINTING OFFICE: 1932

FILE COPY

No. 573

# In the Supreme Court of the United States

OCTOBER TERM, 1931

NORTH AMERICAN OIL CONSOLIDATED, A CORPORATION, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT

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# In the Supreme Court of the United States

OCTOBER TERM, 1931

No. 575

NORTH AMERICAN OIL CONSOLIDATED, A CORPORATION, petitioner

*v.*

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH DISTRICT*

## BRIEF FOR THE RESPONDENT

### OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 130–145) is reported in 12 B. T. A. 68. The amended opinion of the Circuit Court of Appeals (R. 194–203) is reported in 50 F. (2d) 752.

### JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 15, 1931. (R. 193–194.) Petition for rehearing was filed July 15, 1931, and was

denied September 14, 1931. (R. 194.) Petition for a writ of certiorari was filed December 14, 1931, and granted January 25, 1932. (R. 205.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

## STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in Appendix A, *infra*, pp. 35–40.

## QUESTIONS PRESENTED

1. Whether a receiver directed by court order to take charge of a part of the property of the petitioner corporation and impound the receipts arising from oil wells on such property pending the settlement of litigation between the petitioner and the United States was required by Section 13 (c) of the Revenue Act of 1916 to file an income-tax return in respect of such income impounded in 1916.

2. If the receiver was not required to report such income, whether it was taxable to the petitioner for 1916 when the income was impounded, for 1917 when it was released to the petitioner and the receiver discharged, or for 1922 when the litigation was terminated.

## STATEMENT

The petitioner is a California corporation. During all of the years involved it was engaged in the production of oil and derived income from many

parcels of land. (R. 92–111.) On July 15, 1913, the petitioner acquired Section 2, Township 32, Range 23 East, M. D. B. & M., Kern County, California. (R. 116.) Legal title to the land in question was in the United States and it was included within the area described in the presidential withdrawal order of September 27, 1909. Prior to November 30, 1915, the United States instituted suit in the United States District Court for the Southern District of California to oust petitioner from possession of this property and on February 3, 1916, the court entered an order appointing a receiver to operate or supervise the operation of the oil wells on this property and to receive the income arising therefrom. (R. 116–120; *United States* v. *North American Oil Consolidated*, 242 Fed. 723.)

On June 5, 1917, the order appointing the receiver was vacated by final decree of the District Court (R. 120) and the bill was dismissed (242 Fed. 723). The Government appealed and the Circuit Court of Appeals affirmed the decree of the lower court (264 Fed. 336). The case was brought to this Court where the appeal was dismissed under a stipulation of counsel (258 U. S. 633). See mandate of March 21, 1922. (R. 120–122.) On April 12, 1922, a patent to Section 2 was issued by the United States to certain applicants who had agreed to convey to the petitioner.

During the period February 2, 1916, to December 31, 1916, the receiver collected and impounded net

income from the oil wells on the property amounting to $171,979.22. (R. 123, 164.) Petitioner occupied the land and operated the wells under authority of the receiver. The receipts were entered on the books of the petitioner as its income, were not reported as income in its original return for 1916, but were so reported in an amended return filed in 1918. (R. 122.) These receipts were actually turned over to the petitioner in June, 1917, at the time of the District Court's decree. (R. 123.)

Upon auditing the petitioner's income and profits tax returns for 1917, the Commissioner determined a deficiency of $109,239.61, the deficiency being based on other items. (R. 20–30.) The petitioner appealed to the Board of Tax Appeals. In an amended answer to the amended petition filed January 29, 1927, the Commissioner prayed that the deficiency be increased to include the tax on the impounded income paid over by the receiver in that year. (R. 45–48.) In this answer it was stated that the amount of the impounded income was $253,150.96 instead of $171,979.22, but this latter figure was given in the stipulation filed with the Board. (R. 164.)[1]

The Board of Tax Appeals held that the sum in question was not taxable to the petitioner in 1917

[1] The difference between the two sums apparently represents the income received by the receiver after December 31, 1916.

In the memorandum for the respondent in response to the petition for certiorari, page [illegible] it was erroneously stated that the Commissioner prayed for an increase in the deficiency to $253,150.96. The amount should be $128,619.36. (R. 150.)

but was taxable to the receiver in 1916 irrespective of whether the petitioner was on the accrual basis or on the cash receipts and disbursements basis, and found a deficiency of only $35,806.30. (R. 145–146.)

Upon appeal to the Circuit Court of Appeals for the Ninth Circuit that court reversed the decision of the Board, holding that the receiver, as a receiver of only a part of the property of the petitioner, was not required to file a return in its behalf for 1916, and that the income was taxable to the petitioner for 1917 rather than for 1916 or 1922. (R. 194–203.)

## SUMMARY OF ARGUMENT

1. The receiver was in charge of only part of the property of the corporation during 1916.

The language employed in Section 13 (c) of the Revenue Act of 1916, *infra*, indicates that it is only receivers in charge of all of the property or business of a corporation who are required to file returns of income, and the regulations have so construed that provision and similar provisions of later acts. This settled administrative construction of similar statutory provisions is entitled to great weight, particularly in view of the reenactment by Congress of such provisions.

The administrative construction is reasonable. There is no provision for consolidation of return of the receiver of a part of a corporation's property or business and the return of the corporation itself.

2. The Board held it to be immaterial whether the taxpayer filed its returns on the cash basis as the receiver was taxable on the impounded income. The Circuit Court of Appeals reversed the Board holding that the income was taxable to the corporation for 1917 irrespective of the basis on which it filed its returns.

The Board should have made a finding to the effect that the taxpayer filed its returns on the cash receipts and disbursements basis since the returns so indicated (R. 169, 178), the petitioner introduced no evidence to the contrary and the only thing in the record to the contrary was an inconclusive statement in the deficiency letter. (R. 23–24.) Even if the burden of proof as to this issue was upon the Commissioner due to the fact that the question of the taxability of the impounded income was first raised in a claim for increased deficiency asserted before the hearing in accordance with Section 274 (e) of the Revenue Act of 1926, the Commissioner sustained the burden of proving that they were made on the cash basis. If, therefore, the decision in this case turns upon this issue, the respondent should prevail.

Under either system of accounting the income was taxable for 1917.

(a) The cash receipts and disbursements method of accounting requires that a taxpayer report income actually received in cash or its equivalent. In the instant case the income was actually received

during 1917 when the receiver was discharged and the impounded receipts released.

While the oil was produced in 1916, there was at that time no receipt by the petitioner of the proceeds of the sales, and no knowledge on its part as to whether the receipts would be paid to the Government or to it. Nor was there any constructive receipt of the income in 1916. There is nothing in that theory which requires a taxpayer to report income which it may never receive. Nor is the case taken outside the rule that a taxpayer on the cash basis must report income for the year in which it was actually received by the fact that the Government was claiming the receipts in 1917 and continued to claim them until the litigation was finally settled in 1922. Such a theory would be contrary to the principle that the income tax is imposed for a yearly period. Where a taxpayer on the cash basis receives income under a claim of right without restriction as to his disposition of it he is required to report the amount even though claims against the income are being asserted and he may ultimately have to pay an equivalent amount to another. The situation of this taxpayer in 1917 is the antithesis of the situation presented in *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, where the Court held that a taxpayer should report damages as income when he actually receives them.

(b) The accrual of income or of loss involves the establishment of a present right to income or a present liability for expenditure. If the taxpayer was

on, an accrual basis, there could have been no accrual in 1916, since there was then no unconditional right to receive the proceeds of the oil sales. The fact that the taxpayer had entered the amount on its books for 1916 is not conclusive.

During the receivership the petitioner had no more than a claim to the receipts from the land; it did not as in 1917 and thereafter have the receipts themselves as its absolute property which it was free to use as it chose, being itself subject only to a claim of the Government. The determination in 1917 of petitioner's present right to receive the impounded fund constituted an accrual of income just as the determination of the taxpayer's obligation to pay constituted an accrual of loss in *Lucas* v. *American Code Co.*, 280 U. S. 445.

Nor should the reporting of the income be deferred until the year 1922 when the litigation was finally settled. There is little to distinguish the position of a taxpayer on the accrual basis who has earned and collected income but whose right to the income is being disputed and the position of a taxpayer on the cash basis similarly situated.

The petitioner is not excused from reporting income received in 1917 (and in later years as well) because it may later be required to respond to a claim the validity of which is wholly uncertain. The possibility that the taxpayer might have to repay the amount to the Government was a mere contingency which did not prevent the accrual of income.

## ARGUMENT

### I

### THE RECEIVER WAS NOT REQUIRED TO FILE AN INCOME-TAX RETURN FOR 1916 IN BEHALF OF THE PETITIONER AND TO REPORT THEREIN INCOME IMPOUNDED BY HIM DURING THAT YEAR

The first issue raised is whether the receiver should have reported the sum of $171,979.22, derived during 1916 from the sale of oil produced on a parcel of land in Kern County, California, which may conveniently be referred to as Section 2.

The receiver was appointed to take possession only of Section 2 and to impound the receipts arising therefrom. The petitioner owned considerable other property and operated many wells in addition to those on Section 2. (R. 92–110.)

The court below, distinguishing between a situation of this kind and one where the receiver is in charge of the entire business or property of the corporation and is acting for it, held that one who is receiver for only a part of the property of a corporation is not required to file a return or pay a tax in respect of the impounded receipts. We submit that this was a correct conclusion under the law and the regulations.

Section 10 of the Revenue Act of 1916, *infra*, imposes a tax upon "the total net income received in the preceding calendar year from all sources by every corporation." Under Section 13 (a), *infra*, every corporation is required to render returns of such income.

Section 13 (c) of the Revenue Act of 1916 provides as follows:

> In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control.

This provision was left unchanged by the amendments of the Revenue Act of 1916 made by the Revenue Act of 1917, and was thus in effect for both in 1916 and 1917.

The above statute refers to receivers and others who "are operating the property or business of corporations * * *." The use of the definite article "the" in this phrase is some indication that it is only where the receiver is in charge of *all* the property or business of a corporation that he is required to make a return of income in behalf of the corporation. This interpretation is fortified by the fact that the receiver is required to make returns of net in-

come "as and for such corporations" and the tax due thereon is to be assessed and collected "in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control." This language could not have been used if it had been intended that the corporation should file a return in respect of income not falling within the receivership and the receiver another return for the same year of the income of which he had control. On the contrary, the language contemplates a substitution of the receiver for the corporation, and that can occur only when the receiver is in complete charge of all of the property or business of a corporation. Cf. *Reinecke* v. *Gardner*, 277 U. S. 239, involving Section 13 (c) of the Revenue Act of 1916 where the court said (p. 241):

> As under the bankruptcy act the entire property of the bankrupt vested in the trustee, the income in question was not the income of the bankrupt corporation, but of the trustee and was subject to income and excess-profits tax only if the statutes authorized the assessment of the tax against him. * * *

The regulations of the Treasury Department have consistently construed the statutes regarding receivers as applying only to receivers in charge of the entire property or business of a corporation and in all other cases have required corporations themselves to report their income.

Article 26 of Regulations 33, revised, (Revenue Acts of 1916 and 1917), *infra*, p. 38, indicates that it is only a receiver acting in the stead of his principal who is required to file a return and Article 209, *infra*, p. 38, provides as follows:

> Section 13, paragraph C, of this title requires receivers, trustees in bankruptcy, or assignees, who are in charge of and are operating the property and business of corporations, to make returns of annual net income and pay any income tax thereby shown to be due, regardless of what disposition, subject to the orders of the court, may be made of such income.
>
> Notwithstanding the fact that the powers and functions of the corporation are suspended and that the property and business are for the time in control and custody of the receiver, trustee, or assignee, subject to the orders of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required for the purpose of this title to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. The income which he receives on account of the business transacted is the income of the corporation and, no matter how such income is applied, it is subject to the tax imposed by this title in so far as it exceeds the deductions or allowances authorized by law.
>
> The receiver, trustee, or assignee acting for the corporation is required to make a

> true and accurate return of annual net income covering each year or part of each year during which he is in custody and control of the business or properties and will be liable to all the penalties imposed by this title for failure to meet any of its requirements.

Articles 424 and 622 of Regulations 45 (Revenue Act of 1918), *infra,* embody the same rule in more specific language. Article 424 gives as an illustration of receivers not liable—"a receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor," and also receivers in partition proceedings. Article 622 makes it clear, as does Article 209 of Regulations 33, *infra,* p. 38 that it is only in cases where the receiver or trustee is in complete control and the powers and functions of the corporation are for the time being suspended that a receiver or trustee is required to file a return.

It is true that Regulations 45 were promulgated under the Revenue Act of 1918 and Section 225 of that Act changed Section 8 (c) of the Revenue Act of 1916, so as to provide specifically that receivers in possession of only a part of the property of an *individual* need not file a return; but Section 239 of the Revenue Act of 1918, *infra* p. 36, made no corresponding change as to receivers of corporations. Yet the Treasury Department continued to make the same regulations for both individuals and cor-

porations and did not change them in substance from what they had been under the Revenue Act of 1916.

To the same effect are Articles 424 and 622 of Regulations 62, 65, and 69, and Article 392 of Regulations 74 (Revenue Acts of 1921, 1924, 1926, and 1928, respectively).

This settled administrative construction of similar statutory provisions relating to the filing of returns by receivers and trustees in bankruptcy of corporations is entitled to great weight. *Brewster* v. *Gage*, 280 U. S. 327; *National Lead Co.* v. *United States*, 252 U. S. 140. The administrative interpretation has also received legislative approval, since Congress during the period that the regulations were in effect repeatedly enacted provisions as to receivers[2] which in so far as corporations were concerned were identical in all material respects with Section 13 (c) of the Revenue Act of 1916. *Brewster* v. *Gage*, *supra*.

If the departmental construction of Section 13 (c) of the Revenue Act of 1916 had been deemed incorrect, Congress would no doubt have changed the law in the revisions of 1918, 1921, 1924, or 1926. See *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232.

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[2] See Section 239 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1081; Section 239 (a) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 259; Section 239 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 287 (U. S. C., Title 26, Section 991); Section 239 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 45 (U. S. C. App., Title 26, Section 991).

The regulations achieve a reasonable result since there is no provision in the acts for the consolidation of the return of the receiver of part of a corporation's property or business and the return of the corporation itself. It would obviously be unreasonable to require the filing of two separate returns for the same year, each covering only a part of the corporate income without provision for consolidation so that the tax could be based upon the income as a whole.

The case of *Forstmann* v. *Ferguson*, 17 F. (2d) 659 (N. J.), affirmed, 25 F. (2d) 47 (C. C. A. 3d), relied on by petitioner, did not involve any question as to the liability of a receiver for filing returns. The case concerned the taxation of certain dividends declared in 1919 and 1920 upon stock which the Alien Property Custodian had seized as enemy property under the Trading with the Enemy Act of October 6, 1917, c. 106, 40 Stat. 411. In connection with litigation relative to the shares, the court restrained the corporation from paying dividends on the stock in question and the owner from transferring the stock. It was held in that case that, as the corporation was required to hold the dividends under the restraining order, a trust existed and the income was taxable to the corporation as trustee for the years 1918 and 1919 under Sections 219 and 225 of the Revenue Act of 1918, and was not taxable to the owner.

The return that is filed by a receiver or a trustee in bankruptcy in behalf of a corporation is not a

fiduciary return within the meaning of the sections of the 1918 Act considered in the *Forstmann* case. See Article 422 of Regulations 45, *supra*. Nor would it have been under the Revenue Act of 1916. Cf. Sections 8 (c) and 13 (c), *infra*, p. 35. The tax on a fiduciary return is computed as that of an individual (see Section 219) whereas the return filed by a receiver or a trustee in bankruptcy of a corporation under Section 13 (c) of the Revenue Act of 1916 or under Section 239 of the Revenue Act of 1918 is a corporate return. *Reinecke* v. *Gardner*, *supra;* Article 209 of Regulations 33; Article 424 of Regulations 45. The *Forstmann* case seems to have no bearing on the present problem.

The case of *Hart* v. *Commissioner*, 54 F. (2d) 848 (C. C. A. 1st), is somewhat similar to the *Forstmann* case. In that case in a proceeding ancillary to a receivership a receiver of a corporation had secured a judgment against an individual in a state court in a large sum, and instead of requiring a bond to be filed upon appeal that court, upon petition of the defendant for an order segregating his assets, ordered him to turn over to the receiver for the corporation Liberty bonds equal in value to his entire assets. Interest on these bonds was collected by the receiver for the corporation in 1926 and the question was whether it was taxable to him or to the individual. The court held that in so far as the bonds were concerned the receiver for the corporation was in the

position of a trustee holding property for the benefit of an unascertained person and was required to file a return and pay the tax upon the interest, the individual not being taxable.

We submit that under the circumstances of this case there was no duty upon the receiver to file a return, and we pass to a consideration of the year for which the income should be taxed to the petitioner, which received it in 1917.

## II

### THE RECEIPTS IMPOUNDED IN 1916 AND RELEASED AND PAID OVER TO THE PETITIONER IN 1917 ARE TAXABLE TO THE PETITIONER FOR THE YEAR 1917 WHEN RELEASED AND NOT FOR 1916 WHEN IMPOUNDED, OR FOR 1922 WHEN THE DECREE UNDER WHICH THEY WERE RELEASED WAS AFFIRMED ON APPEAL

The Board of Tax Appeals made no finding as to whether the taxpayer filed its returns on the cash receipts and disbursements basis or on the accrual basis, although the Commissioner asserted that the former was true (R. 139), but held that the fact was immaterial, since the receiver was required to report the impounded income. In his petition for review by the Circuit Court of Appeals, the Commissioner asserted that the taxpayer was on the cash receipts and disbursements basis during the years in question (R. 148), and assigned as error the holding of the Board of Tax Appeals that it was immaterial whether taxpayer's accounts were kept on that basis. (R. 150.) The court below did not pass upon the question but reversed the Board,

holding that under either system of accounting the income was taxable for 1917.

Although the record is not wholly free from doubt, we think that the Board should have found that the returns were filed on a cash basis. The returns for 1916 and 1917 contained a statement to the effect that they were filed on the cash basis. (R. 169, 178.) While this statement is not conclusive (*Aluminum Castings Co. v. Routzahn*, 282 U. S. 92, 99), it is entitled to considerable weight, particularly since the returns show that no inventories were taken and there is nothing in them to contradict the statement that they were filed on the cash basis.

The taxpayer introduced no evidence as to the basis upon which the returns were filed and the only things in the record which might be taken to indicate an accrual basis are certain statements in the deficiency letter for 1917 to the effect that the Commissioner had disallowed taxes paid in excess of accruals. (R. 23, 24.) We think the statement is susceptible of more than one meaning. It might mean that taxes had been paid before they became due and were not considered a proper charge for that year.[8]

[8] The deficiency letter for 1918 and 1919 (the appeal in that case having been consolidated with the instant case before the Board) recites that interest receivable accrued had been disallowed in accordance with Article 87 of Regulations 45. (R. 68.) The references to accruals in the 1918 and 1919 deficiency letter have no real bearing on this question but in any event they are not clear since the same letter refers to the allowance of a deduction of taxes paid. (R. 69.)

The petitioner argues that the question of the taxability of the impounded income for 1917 was not raised in the original deficiency letter but in a claim for an increased deficiency and hence that the burden of proof as to the basis of filing the returns rested upon the Commissioner.

It is our position that the presumption of correctness of the Commissioner's determination attaches to the increased deficiency as well as to the original deficiency and that the Board's rules so far as they provide otherwise should be disregarded as not in accordance with the law; but (assuming that a cash basis is essential to sustain the tax) even if the burden of proof were on the Commissioner that burden has been sustained. This argument is developed more at length in Appendix B of the brief, *infra*, p. 41.

But we submit that the court below correctly decided that irrespective of the basis of filing the returns the income was taxable for 1917 and proceed to deal with the case under both the cash and the accrual theory.

(a) *If the taxpayer was on the cash basis the income was taxable for 1917, when it was actually received, and not for 1916 or 1922*

The petitioner argues that if the income was not taxable to the receiver for 1916 it was taxable to the corporation either for 1916 when the income was produced or in the alternative for the year 1922 when the Government's claim to it was finally determined to be invalid.

We understand the petitioner's contention that the income was taxable for 1916 to be based entirely on the assumption that the return was filed on the accrual basis and that it does not deny that the income would be taxable for 1917 if the return was on the cash basis. If, however, we are in error as to a concession being made, we submit that any other position is wholly without support.

The theory of a cash receipts and disbursements method of accounting is that from income actually received in cash or its equivalent during the taxable year there are deducted expenses actually paid. *United States* v. *Anderson*, 269 U. S. 422; *United States* v. *Mitchell*, 271 U. S. 9; *Eckert* v. *Burnet*, 283 U. S. 140; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S. 92; *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359.

There was no physical receipt of the impounded income in 1916. There was such receipt in 1917 when the impounded funds were released to and received by the taxpayer. Under the cash basis of accounting the amount was taxable for 1917, the year of its receipt.

Clearly, the amount could not be taxed as an amount received during 1916, even if it had been known at that time that payment would be made in 1917, which was not the case. In *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, this Court distinguished between the actual receipt of cash and money to be received in the future; and in *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, the

Court held that a taxpayer on the cash basis should be required to report damages recovered as income for the year in which the judgment was paid and not for earlier years in which amounts were expended in the attempted performance of the contract there involved.

Under those decisions we submit that the impounded income was received in 1917 and was taxable for that year.

The petitioner apparently does not invoke the doctrine that one may be taxed upon income which he has constructively, if not actually, received, and we have found no phase of that doctrine which will fit the instant case.[4] There is nothing in that

[4] The most generally applied rule of constructive receipt is that a taxpayer may be taxed upon income not yet received when the amount has been unqualifiedly made subject to his demand during the taxable year and its receipt or nonreceipt is a matter within his own control. *Commissioner* v. *Bingham* (C. C. A. 6th), 35 F. (2d) 503, certiorari denied, 281 U. S. 729; *Hadley* v. *Commissioner* (App. D. C.), 36 F. (2d) 543; *Brooks* v. *Commissioner* (C. C. A. 4th), 35 F. (2d) 178; *Schoenheit* v. *Lucas* (C. C. A. 4th), 44 F. (2d) 476. Cf. *Commissioner* v. *Adams* (C. C. A. 1st), 54 F. (2d) 228. In the instant case the order appointing the receiver had destroyed the power of the corporation to collect the income and it had no right to demand payment from the receiver.

The instant case is not within the rule of *Old Colony Trust Co.* v. *Commissioner*, 279 U. S. 716, and *United States* v. *Boston & M. R. Co.*, 279 U. S. 732, in which it is recognized that one may receive taxable income through the payment of his obligation by another.

Nor is it within the rule of decisions recognizing that a person may be taxed upon income of which he is not the ultimate beneficial owner when he has voluntarily deprived

theory which requires a taxpayer to report income which it may never receive. *Burnet* v. *Logan*, 283 U. S. 404.

Nor is the case taken outside the rule that a taxpayer on the cash basis must report income for the year in which it is actually received by the fact that the Government was claiming the income in 1917, and continued to claim it until the litigation was finally terminated in 1922. We submit that a taxpayer who has received payment under a claim of right and without restriction as to his disposition of it has received income which he is required to report, even though others may claim that he is not entitled to the payment and is accountable to them.

To hold otherwise would do violence to the principle that the income tax is one imposed for an annual period; that it takes into consideration yearly gains and losses. *Burnet* v. *Thompson Oil & Gas Co.*, 283 U. S. 301; *Burnet* v. *Sanford & Brooks Co., supra; De Loss* v. *Commissioner*, 28 F. (2d) 803 (C. C. A. 2d).

That a taxpayer on the cash basis may not defer reporting income actually received under a claim of right on the ground that claims are being asserted the outcome of which may later deprive him of it, was decided in *Board* v. *Commissioner*, 51 F. (2d)

himself of such ownership by an independent agreement or deed. *Leininger* v. *Commissioner*, No. 426, decided March 14, 1932; *Lucas* v. *Earl*, 281 U. S. 111; *Mitchel* v. *Bowers* (C. C. A. 2d), 15 F. (2d) 287, certiorari denied, 273 U. S. 759.

73 (C C. A. 6th), certiorari denied, 284 U. S. xv. In that case corporation A sold all of its assets and went into liquidation. At that time A had entered into a contract for the construction of a pipe line. The other party to the contract was unable to finance his part of the agreement. It was taken over by the liquidating trustees and two other officers and the pipe line was constructed on the joint credit of A and the five officers. Upon the sale of the properties of A, the liquidating trustees distributed a part of the proceeds to the taxpayer and other liquidating trustees in 1920. Certain stockholders contested this distribution and filed an action which was not finally settled until 1927. In holding that the taxpayer was required to report the amount as income for 1920 rather than for 1927, the court said (pp. 75–76):

> We are of the opinion that the board was right in allocating this income to the year 1920. That it was actually received during that year is not disputed; nor is it disputed that it was received under a claim of right and as profits to which the petitioner was justly entitled. The only claim made is that the contract whereby petitioner purported to secure his interest in the pipe line was illegal and unenforceable by reason of his position as a director of the Old Dominion Oil Company. In this contention the petitioner of course never acquiesced. The payment was never refunded. Possibly it might have been recovered in the litigation which

> was instituted for that purpose, but it was not, and it is at least unusual that a taxpayer should be heard to assert the possibility of an adjudication of alleged misconduct and breach of trust, as relieving him from tax liability which is predicated upon the assumption of the honesty and legality of his acts. Obviously, the sum involved must be considered as income either for the year 1920 or 1927, and we think that it must be allocated to the year 1920, in which it was actually received, rather than to the year 1927, in which the taxpayer's right to retain it was established.

The situation in the present case is very similar to that in the *Board* case and the same principle should apply. These two cases present a corollary to the rule in *Burnet* v. *Sanford & Brooks Co., supra.*

In that case the taxpayer brought an action against the Government for damages, alleging that the Government had failed to make a proper disclosure as to the character of the material which the taxpayer contracted to dredge. The judgment was not recovered and paid until 1920, and the Court held that the amount paid on the judgment was taxable for that year and not for the earlier years. The difference between that case and the case at bar is that there the taxpayer in the earlier years was claiming a right to income which it had not received, whereas here the taxpayer during the earlier year was not only asserting its claim to the income but had actually collected it.

If in this case the taxpayer had finally lost its appeal and been obliged to account for the profits, it would have been entitled to a deduction for a loss in that year, but the obligation of reporting the income actually realized in 1917 was not affected by the fact that a loss might be sustained in the future.

This is analogous to the rule that limitations which may affect the right to dispose of income do not prevent it from being taxed when received. *Cleveland Ry. Co.*, v. *Commissioner*, 36 F. (2d) 347 (C. C. A. 6th), certiorari denied, 281 U. S. 743; *Newman* v. *Commissioner*, 40 F. (2d) 225 (C. C. A. 10th), certiorari denied, 282 U. S. 858; *Rodrigues* v. *Edwards*, 40 F. (2d) 408 (C. C. A. 2d).

(*b*) *Assuming for the sake of argument that the taxpayer was on the accrual basis, the impounded receipts were nevertheless taxable for 1917 and not for 1916 or 1922*

The petitioner's argument that the impounded receipts represented accrued income for 1916 rather than 1917 is apparently based on two contentions: (1) that the income was entered on the books of the corporation as earned or accrued income during 1916, and (2) that the test of the accrual of income is not whether the taxpayer has the present beneficial use of or right to the income but whether the right to it is ultimately established. It claims that the effect of the decision in *United States* v. *North American Oil Consolidated*, 264 Fed. 336 (C. C. A. 9th), is that at all times the petitioner was entitled to the possession of Section 2 and to the income

realized therefrom and hence that it had a right to such income in 1916 and should be taxed upon it for that year.

Section 13 (d) of the Revenue Act of 1916, *supra*, permits a taxpayer to file a return in accordance with the method of accounting employed in keeping its books, provided the method employed clearly reflects income. This does not mean, however, that the fact that an item has been entered on the books as an accrual in a particular year conclusively shows that it was properly accrued in that year or that the Commissioner may not correct an item improperly accrued. *United States* v. *American Can Co.*, 280 U. S. 412; *Aluminum Castings Co.* v. *Routzahn*, 282 U. S. 92.

The general rule is that income may be said to have accrued when it is earned (*United States* v. *Anderson*, 269 U. S. 422), and, in the case of income derived from the sale of property, income may be said to have accrued to the vendor when the vendee's obligation to pay has become unconditional. *United States* v. *American Can Co., supra; Lucas* v. *North Texas Co.*, 281 U. S. 11; *Evergreen Cemetery Ass'n* v. *Burnet*, 45 F. (2d) 667 (App. D. C.); *Rouss* v. *Bowers*, 30 F. (2d) 628 (C. C. A. 2d), certiorari denied, 279 U. S. 853.

While the source of the income here involved was the production and sale of oil in 1916, the petitioner first acquired the right to be paid the proceeds of the sales in 1917 when the receiver was discharged and the impounded funds released. (R. 120.)

Thus, while an unconditional liability on the part of purchasers to pay for the oil existed prior to 1917, there was no corresponding right in the petitioner to collect. The property was in *custodia legis* and neither claimant could assert dominion or control over the corpus of the estate or the income. The rights of both the parties were in suspension during the receivership. Hence the broad principles laid down in *Lucas* v. *North Texas Co., supra,* and other cases just cited have only a general application to this case and do not furnish a determinative rule.

The accrual of income or of loss involves a present right to income or a present liability for expenditure. Accrual occurs only when gain or loss is realized, or where the right or the liability can be established and is ascertainable with reasonable certainty. *Lucas* v. *American Code Co., supra,* p. 449. In this case the amount of the 1916 receipts which the petitioner would acquire upon the dissolution of the receivership may have been ascertainable in that year; but whether the petitioner would then, or ever, acquire them was not certain in 1916 and could not in that year be established to a reasonable degree of certainty, or indeed to any degree of certainty.

With respect to whether the income in question accrued in 1916 or 1917, this case closely resembles, in principle, the case of *Lucas* v. *American Code Co., supra.* There it was held that the taxpayer could not, during the period intervening between

the breach of a contract and the final adjudication of its liability therefor, deduct in the form of an annual reserve the damages which it estimated might be payable. There existed only a claim; neither liability nor amount was presently ascertainable. So in this case, petitioner had during the period of receivership nothing more than a claim to the receipts from the land; it did not, as was the case in 1917 and thereafter, have actual dominion over the receipts as its absolute property, the petitioner itself then being subject only to a claim of the Government which might or might not be established. And the validity of petitioner's claim to the receipts during receivership must be said to have been uncertain and unascertainable by reason of the fact that in the deliberate judgment of a Federal district court it was so uncertain as to require the court, for the protection of the interest of the adverse claimant, to take from the petitioner the benefit of those receipts and place the receipts themselves in *custodia legis* pending its own determination of the controversy as to who should receive them. The fact that in 1917 the petitioner was held to be entitled to, and did, receive them can not be given retrospective effect for the purpose of determining *in 1916* that the impounded receipts accrued to the petitioner as income for that year. The determination, in 1917, of petitioner's present right to *receive* the impounded fund constituted an accrual of income in this case, just as the determina-

tion of the taxpayer's obligation to *pay* constituted an accrual of loss in the *American Code* case. See also *Pharr & Sons, Ltd.* v. *Commissioner* (C. C. A. 5th) net yet reported, decided March 19, 1932.

The conclusion of the court below that the income was not accrued in 1916 is in accord with the decision in *Corn Exchange Bank* v. *United States,* 37 F. (2d) 34 (C. C. A. 2d), where it was held that a taxpayer is not obliged to report interest which it has entered on its books as an accrued item where at the end of the year the debtor was in the hands of a receiver and the probabilities were that the interest would not be collected. In this case, where the receipt of the income depended not upon the condition of the debtor but upon the outcome of pending litigation, there seems to be stronger reason for not accruing the income in 1916.

See also *Becker Bros.* v. *United States,* 7 F. (2d) 3 (C. C. A. 2d); *Malleable Iron Range Co.* v. *United States,* 62 C. Cls. 425, 273 U. S. 674, 65 C. Cls. 441; *Commissioner* v. *Southeastern Express Co.* (C. C. A. 5th), decided March 4, 1932, not yet reported.

The decision in *Obispo Oil Co.* v. *Welch,* 48 F. (2d) 872 (S. D. Cal.), is *contra* and is now pending before the same Circuit Court of Appeals that decided the instant case. The facts in that case were the same as in this, except that the corporation had originally reported the income for the years in which the oil was produced notwithstanding the receivership, and the litigation was terminated by

a settlement in 1920. The District Court held the income to be taxable for the earlier years.[5]

We have heretofore discussed the question of accrual in 1917 as against accrual in 1916. The petitioner, in an alternative argument, urges that if the income was not taxable for 1916 it was not subject to tax until 1922 when the litigation with the Government was finally terminated. It relies upon *Consolidated Tea Co.* v. *Bowers,* 19 F. (2d) 382 (S. D. N. Y.).

As previously pointed out, in *Board* v. *Commissioner,* 51 F. (2) 73 (C. C. A. 6th), certiorari denied, 284 U. S. xv, it was recognized that a taxpayer on the cash basis may not refuse to report income actually received under a claim of right on the ground that claims are being asserted which may later deprive him of it. There seems to be little difference between the position of the taxpayer in that case and the position of a taxpayer on the accrual

[5] The Court's attention should be called to the case of *Commissioner* v. *Old Dominion S. S. Co.*, 47 F. (2d) 148 (C. C. A. 2d), where the court held that there should be taxed to a carrier as accrued income during the period of Federal control not only the compensation representing the standard return, but also the excess allowed over the standard return although the amount of the excess was not determined until a later year. We think that decision, whether right or wrong, is distinguishable on the facts. The same question is now before the Circuit Court of Appeals for the Tenth Circuit in the case of *Commissioner* v. *Midland Valley Railroad Co.* (see 19 B. T. A. 423). See also *Kentucky & Indiana Terminal Railroad Co.* v. *Commissioner*, 54 F. (2d) 738 (C. C. A. 6th), petition for certiorari filed, No. 817, October Term, 1931.

basis who has earned and collected income and holds it as free assets but whose right to it is being disputed. The reasoning of the court in that case supports the decision here.

The case of *United States* v. *White Dental Co.*, 274 U. S. 398, is also applicable, whether the taxpayer is on the cash or the accrual basis. If under that decision a taxpayer is not compelled to defer a deduction for a loss realized with respect to a German-owned subsidiary during the World War until it should be ascertained that there was no possibility of a recovery by an award of the Mixed Claims Commission, by a parity of reasoning the taxpayer in this case should not be permitted to defer reporting income actually received because of the possibility that it may later have to pay a corresponding amount to the Government. The termination of the litigation in 1922 gave the taxpayer nothing that it did not already have; it merely relieved petitioner of the possibility of being required to account to and compensate the United States for a wrongful occupancy and use of the land. In the *White* case taxpayer was not precluded from deducting the value of property lost, because he owned a claim the enforceability of which was uncertain. In this case petitioner is not excused from reporting income received in 1917 (and in the later years as well), because it may later be required to respond to a claim the validity of which is wholly uncertain.

On this aspect of the case our position that the income was accrued prior to the termination of the litigation is contrary to the decision in *Commissioner* v. *Brown,* 54 F. (2d) 563, (C. C. A. 1st) (pending on petition for certiorari by the Commissioner, October Term, 1931, No. 776, petition for certiorari also filed by taxpayer, No. 797.) In that case a partnership transacted its wool business during 1918 and 1919 under a permit issued by the War Industries Board. The regulations of the Board provided *inter alia* that the Government should have a prior right to acquire all of the 1918 wool clip at prices to be officially fixed plus certain compensation for distribution charges and that if at the end of the season the gross profits (including the commission) were found to be in excess of 5% the excess profits should be disposed of as the Government should subsequently direct. The partnership refused to give up the excess profits for distribution to the growers as the Government demanded and was sued by the Government, the litigation terminating in the partnership's favor in 1930. It was held that the income was taxable for 1930. The court in that case in substance decided that a taxpayer on the accrual basis may not be taxed upon income which he has earned and collected while claims are being asserted against him on account of it or litigation is pending which may deprive him of it. We think the decision wrong.

The decision in the *Consolidated Tea Company* case, *supra,* relied upon by petitioner is not opposed

to the decision in this case. The sole question there was whether the taxpayer could in 1919 deduct as a loss a judgment rendered against it by a lower court in 1919 and affirmed by the appellate court in 1921 and paid in 1921. That case might have some resemblance to the case at bar if the judgment had actually been paid in 1919, but as it stands it is not authority for the proposition that a corporation, which has collected money as a part of its income and used it in its business as it would any other funds, may refrain from reporting the income because its right to retain the amount is being litigated. Cf. *Lucas* v. *American Code Co., supra.*

In *Vang* v. *Lewellyn,* 35 F. (2d) 283 (C. C. A. 3d), the court held, in substance, that a road contractor could not refuse to accrue income realized under a contract until the end of a five-year period on the ground that it had obligated itself to maintain the road during that period. The court pointed out that the liability for maintenance was contingent upon the need for maintenance and that gain or loss on the contract was realized when the contract was completed, notwithstanding the possibility that expenses might thereafter be incurred. See also the decision of the lower court in the same case, *Harrison* v. *Heiner,* 28 F. (2d) 985 (W. D. Pa.).

In this case also, the termination of the litigation in 1922 might have had some bearing upon petitioner's right to a deduction in that year had it not prevailed, but it did not serve to prevent the accrual of income in 1917.

## CONCLUSION

The Circuit Court of Appeals properly held that the receiver was not required to file a return with respect to the impounded receipts and that the petitioner was taxable thereon as income for the year 1917.

Respectfully submitted.

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APRIL, 1932.

# APPENDIX A

## STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1916, c. 463, 39 Stat. 756, 765, 767, 770, 771:

SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income; * * *

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—

* * * * *

SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first;

* * * * *

(c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this

title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control; * * *

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1074, 1081:

SEC. 225. That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the net income of such estate or trust is $1,000 or over or if any beneficiary or such estate or trust is a nonresident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and

that the same is, to the best of his knowledge and belief, true and correct.

* * * * *

SEC. 239. That every corporation subject to taxation under this title and every personal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

* * * * *

Revenue Act of 1926, c. 27, 44 Stat. 9, 56:

SEC. 274. (e) The Board shall have jurisdiction to redetermine the correct amount of the deficiency even if the amount so redetermined is greater than the amount of the deficiency, notice of which has been mailed to the taxpayer, and to determine whether any penalty, additional amount or addition to the tax should be assessed, if claim therefor is asserted by the Commissioner at or before the hearing or a rehearing. (U. S. C. Sup. V. Title 26, Sec. 1048(c).)

Treasury Regulations 33 (Revised):

Art. 26. * * *

RULINGS ON MAKING RETURNS

* * * * *

181. Receivers who, as officers of a court, stand in the stead of some principal are required to account for income tax as the principal would have been required to account.

* * * * *

ART. 209. *Receivers to make returns.*—Section 13, paragraph C, of this title requires receivers, trustees in bankruptcy, or assignees, who are in charge of and are operating the property and business of corporations, to make returns of annual net income and pay any income tax thereby shown to be due, regardless of what disposition, subject to the orders of the court, may be made of such income.

Notwithstanding the fact that the powers and functions of the corporation are suspended and that the property and business are for the time in control and custody of the receiver, trustee, or assignee, subject to the orders of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required for the purpose of this title to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. The income which he receives on account of the business transacted is the income of the corporation and, no matter how such income is applied, it is subject to the tax imposed by this title in so far as it exceeds the deductions or allowances authorized by law.

The receiver, trustee, or assignee acting for the corporation, is required to make a true and accurate return of annual net income covering each year or part of each year during which he is in custody and control of the business or properties and will be liable to all the penalties imposed by this title for failure to meet any of its requirements.

Treasury Regulations 45:

ART. 424. *Return by receiver.*—A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on form 1040 (revised) or 1040 A (revised). When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be made as if by the corporation itself. See section 239 of the statute and article 622. A receiver in charge of the business of a partnership shall render a return on form 1065 (revised). A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common-law receivers of all the property or business of an individual or poration must make returns. See also section 256 of the statute and articles 1071–1080.

ART. 622. *Returns by receivers.*—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on

form 1120, covering each year or part of a year during which they are in control. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. See articles 424 and 547.

## APPENDIX B

The petitioner argues that, since the tax which is the subject of controversy here was not a part of the original deficiency but was claimed as an increased deficiency in the answer of the Commissioner, the burden of proof was upon the Commissioner and he has failed to sustain that burden.

Rule 30 of the Board of Tax Appeals provides:

> BURDEN OF PROOF.—The burden of proof shall be upon the petitioner, except as otherwise provided by statute and except that in respect of any new matter pleaded in his answer, it shall be upon the respondent.

We concede that the Board of Tax Appeals has consistently applied the last part of this rule to cases like the case at bar, where a taxpayer has taken an appeal to the Board in reference to certain matters and the Commissioner at or before the hearing or rehearing has asserted a claim for an increased deficiency based on other matters in accordance with Section 274 (e) of the Revenue Act of 1926, *infra*. It has construed the claim for increased deficiency as an affirmative pleading and has held that the burden of proof with respect to it is upon the Commissioner. *Henderson Tire & Rubber Co.*, 12 B. T. A. 716; *Schilling Grain Co.*, 8 B. T. A. 1048; *General Lead Batteries Co.*, 2 B. T. A. 392; *Crider Brothers Commission Co.*, 10 B. T. A. 338, affirmed on other grounds, 45 F. (2d) 974, certiorari denied, 283 U. S. 834. This applica-

tion of its rule appears to be based on the theory that the original deficiency notice carries with it a presumption of the correctness of the Commissioner's determination, and that the increased deficiency which necessarily challenges the correctness of the first determination can not also be treated as being presumptively correct. See *Georgiana McFetridge*, 9 B. T. A. 759; *Rines Real Estate Co.*, 12 B. T. A. 1370. In the *Schilling Grain Company* case, the Board said (pp. 1057–1058):

> The burden of proving this allegation is upon the respondent and unless it is shown by a preponderance of the evidence that his allowance (that is, the original deficiency letter) was erroneous, we would not be justified in changing his previous action. * * *

Whether the Board is justified in holding that the burden of proof rests upon the Commissioner in cases like the *Schilling Grain Company* case and the case at bar has not been passed upon by any court. It seems to conflict with the rule generally recognized in proceedings before the Board as well as in suits to recover a tax already paid that the Commissioner's determination is *prima facie* correct or presumptively correct and that in all such proceedings the burden of proving the Commissioner wrong is upon the taxpayer. *Niles Bement Pond Co.* v. *United States*, 281 U. S. 357; *Wickwire* v. *Reinecke*, 275 U. S. 101; *Reinecke* v. *Spalding*, 280 U. S. 227; *United States* v. *Mitchell*, 271 U. S. 9; *Lucas* v. *Kansas City Structural Steel Co.*, 281 U. S. 264; *Burnet* v. *Houston*, 283 U. S. 223.

There seems to be no reason for applying a different rule when the determination of the Commissioner is represented in an increased deficiency. Section 274 (e) of the Revenue Act of 1926 gives

authority to the Commissioner to assert an increased deficiency at or before a hearing or rehearing. See also *Cement Gun Co.* v. *Commissioner* (App. D. C.), 36 F. (2d) 107; *Moise* v. *Burnet*, 52 F. (2d) 1071 (C. C. A. 9th). The power of the Commissioner to redetermine a tax was conceded by this Court in *Burnet* v. *Porter*, 283 U. S. 230. The reason for presuming the correctness of the original assertion of the Commissioner applies with equal force to this supplemental assertion, and it would seem that in a case of this sort the second determination should be considered a correction of the first and the two considered together as a single determination to which the presumption of correctness attaches.

This conclusion is supported by the case of *Austin Co.* v. *Commissioner*, 35 F. (2d) 910 (C. C. A. 6th), certiorari denied, 281 U. S. 735. In that case the Commissioner had allowed a refund of 1917 taxes based on the taxpayer's claim for special assessment. Later, while the Revenue Act of 1924 was in effect, the Commissioner asserted a deficiency in tax and the taxpayer appealed to the Board. The court after distinguishing the case of *Woodworth* v. *Kales*, 26 F. (2d) 178 (C. C. A. 6th), in which it had held that the Commissioner could not reverse a previous determination, on the ground that in the *Woodworth* case it affirmatively appeared that the new action of the Commissioner was not based upon any fraud or mistake of law or fact but upon a changed inference of fact from the same evidentiary facts, said (p. 912):

> It is settled by the decisions of the Supreme Court that the findings of the com-

missioner are prima facie correct, and that the taxpayer who complains of them has the burden before the Board of Tax Appeals of showing that they are wrong. *Wickwire* v. *Reinecke,* 275 U. S. 101. It is said, however, that the presumption which arose from the fact of this additional assessment was overcome by a like presumption attaching to the original assessment, and that the burden was on the commissioner to show that his later action was taken for reasons authorized in the Woodworth Case. We can not concur in that view. The question before the Board concerned the additional assessment, not the earlier one. The action of the commissioner in making it was under attack. The law gave him the right to make it under certain circumstances. There is a presumption that he performed his duty, that is, that he acted upon all the facts before him, including new and different ones. *United States* v. *Chemical Foundation,* 272 U. S. 1. This presumption of the existence of such new facts is not inconsistent with the presumption attaching to the first assessment, that the commissioner acted upon all the facts then before him. Moreover, it was within the power of the petitioner to obtain the facts of both assessments through the processes of the Board of Tax Appeals. *Blair* v. *Oesterlein Machine Co.,* 275 U. S. 220. It did not do this, but relied upon lack of authority in the commissioner to make any further assessment. Even though there was lack of authority to make such assessment upon a changed view of the same facts, there was not lack of authority to make it where there was fraud or mistake of law or fact in the original assessment. In this situation the burden was on the petitioner to show that the com-

missioner's action grew out of circumstances which did not warrant it.

Cf. *Lewis* v. *Reynolds*, No. 115, October Term, 1931, decided January 4, 1932.

It is true that the appeal to the Board in the *Woodworth* case was taken under the Revenue Act of 1924 which contained no provision similar to Section 274 (e) of the Revenue Act of 1926, and that there was not an assertion of two deficiencies; but in that case as in this there were two determinations by the Commissioner and the question was whether the first or second determination of a Commissioner should control. The assertion of a deficiency by a sixty-day letter is essentially the same as and of no greater dignity than the assertion of it by the Commissioner's answer, and the reasoning in the *Austin* case applies here. See also *L. Loewry & Son* v. *Commissioner*, 31 F. (2d) 652 (C. C. A. 2d).

Even if the Board's rule should be sustained, we think the Commissioner sustained the burden of proof in this case by offering the return in evidence and that, the taxpayer having offered no evidence tending to contradict the statement on the return that they were made on a cash basis, the Board should have made a finding to that effect.

U. S. GOVERNMENT PRINTING OFFICE: 1932

# SUPREME COURT OF THE UNITED STATES.

No. 575.—October Term, 1931.

North American Oil Consolidated, Petitioner,
*vs.*
David Burnet, Commissioner of Internal Revenue.

On Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

[May 23, 1932.]

Mr. Justice Brandeis delivered the opinion of the Court.

The question for decision is whether the sum of $171,979.22 received by the North American Oil Consolidated in 1917, was taxable to it as income of that year.

The money was paid to the company under the following circumstances. Among many properties operated by it in 1916 was a section of oil land, the legal title to which stood in the name of the United States. Prior to that year, the Government, claiming also the beneficial ownership, had instituted a suit to oust the company from possession; and on February 2, 1916, it secured the appointment of a receiver to operate the property, or supervise its operations, and to hold the net income thereof. The money paid to the company in 1917 represented the net profits which had been earned from that property in 1916 during the receivership. The money was paid to the receiver as earned. After entry by the District Court in 1917 of the final decree dismissing the bill, the money was paid, in that year, by the receiver to the company. *United States* v. *North American Oil Consolidated*, 242 Fed. 722. The Government took an appeal (without supersedeas) to the Circuit Court of Appeals. In 1920, that Court affirmed the decree. 264 Fed. 336. In 1922 a further appeal to this Court was dismissed by stipulation. 258 U. S. 633.

The income earned from the property in 1916 had been entered on the books of the company as its income. It had not been included in its original return of income for 1916; but it was included in an amended return for that year which was filed in

1918. Upon auditing the company's income and profits tax returns for 1917, the Commissioner of Internal Revenue determined a deficiency based on other items. The company appealed to the Board of Tax Appeals. There, in 1927 the Commissioner prayed that the deficiency already claimed should be increased so as to include a tax on the amount paid by the receiver to the company in 1917. The Board held that the profits were taxable to the receiver as income of 1916; and hence made no finding whether the company's accounts were kept on the cash receipts and disbursements basis or on the accrual basis. 12 B. T. A. 68. The Circuit Court of Appeals held that the profits were taxable to the company as income of 1917, regardless of whether the company's returns were made on the cash or on the accrual basis. 50 F. (2d) 752. This Court granted a writ of certiorari. 284 U. S. 614.

It is conceded that the net profits earned by the property during the receivership constituted income. The company contends that they should have been reported by the receiver for taxation in 1916; that if not returnable by him, they should have been returned by the company for 1916, because they constitute income of the company accrued in that year; and that if not taxable as income of the company for 1916, they were taxable to it as income for 1922, since the litigation was not finally terminated in its favor until 1922.

*First.* The income earned in 1916 and impounded by the receiver in that year was not taxable to him, because he was the receiver of only a part of the properties operated by the company. Under § 13 (c) of the Revenue Act of 1916,[1] receivers who "are operating the property or business of corporations" were obliged to make returns "of net income as and for such corporations", and "any income tax due" was to be "assessed and collected in the

[1] Act of September 8, 1916, 39 Stat. 756, 771, c. 463: "In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations . . . , subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations . . . , in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose business or properties they have custody and control."

same manner as if assessed directly against the organization of whose business or properties they have custody and control." The phraseology of this section was adopted without change in the Revenue Act of 1918, 40 Stat. 1057, 1081, c. 18, § 239. The regulations of the Treasury Department have consistently construed these statutes as applying only to receivers in charge of the entire property or business of a corporation; and in all other cases have required the corporations themselves to report their income. Treas. Regs. 33, arts. 26, 209; Treas Regs. 45, arts. 424, 622 That construction is clearly correct. The language of the section contemplates a substitution of the receiver for the corporation; and there can be such substitution only when the receiver is in complete control of the properties and business of the corporation. Moreover, there is no provision for the consolidation of the return of a receiver of part of a corporation's property or business with the return of the corporation itself. It may not be assumed that Congress intended to require the filing of two separate returns for the same year, each covering only a part of the corporate income, without making provision for consolidation so that the tax could be based upon the income as a whole.

*Second.* The net profits were not taxable to the company as income of 1916. For the company was not required in 1916 to report as income an amount which it might never receive. See *Burnet* v. *Logan,* 283 U. S. 404, 413. Compare *Lucas* v. *American Code Co.,* 280 U. S. 445, 452; *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359, 363. There was no constructive receipt of the profits by the company in that year, because at no time during the year was there a right in the company to demand that the receiver pay over the money. Throughout 1916 it was uncertain who would be declared entitled to the profits. It was not until 1917, when the District Court entered a final decree vacating the receivership and dismissing the bill, that the company became entitled to receive the money. Nor is it material, for the purposes of this case, whether the company's return was filed on the cash receipts and disbursements basis, or on the accrual basis. In neither event was it taxable in 1916 on account of income which it had not yet received and which it might never receive.

*Third.* The net profits earned by the property in 1916 were not income of the year 1922—the year in which the litigation with

the Government was finally terminated. They became income of the company in 1917, when it first became entitled to them and when it actually received them. If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent. See *Board* v. *Commissioner of Internal Revenue*, 51 F. (2d) 73, 75, 76. Compare *United States* v. *S. S. White Dental Manufacturing Co.*, 274 U. S. 398, 403. If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year. Compare *Lucas* v. *American Code Co., supra.*

*Affirmed.*

A true copy.

Test:

*Clerk, Supreme Court, U. S.*